Docket for 03-184

(12)

No. 03-184
Title: Claude M. Ballard, et ux., Petitioners
v.
Commissioner of Internal Revenue
Docketed: August 6, 2003
Lower Ct: United States Court of Appeals for the Eleventh Circuit
Case Nos.: (01-17249, 01-17251, 01-17253, 01-17255, 01-17256, 01-17257)
Decision Date: February 13, 2003
Rehearing Denied: May 5, 2003
Questions Presented

~~Date~~	~~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~
Aug 4 2003	Petition for writ of certiorari filed. (Response due September 5, 2003)
Aug 26 2003	Order extending time to file response to petition to and including October 6, 2003.
Sep 30 2003	Letter of September 26, 2003, received from counsel for petitioner.
Oct 6 2003	Brief of respondent Commissioner of Internal Revenue in opposition filed.
Oct 6 2003	Brief amici curiae of David Pryor, et al. filed.
Oct 6 2003	Brief amicus curiae of Joshua S. Kanter filed.
Oct 20 2003	Reply of petitioners Claude M. Ballard and Mary B. Ballard filed.
Oct 22 2003	DISTRIBUTED for Conference of November 7, 2003.
Apr 7 2004	DISTRIBUTED for Conference of April 23, 2004.
Apr 26 2004	Petition GRANTED This case is consolidated with No. 03-1034, Estate of Kanter v. CIR, and a total of one hour is allotted for oral argument.
Jun 4 2004	Extension of time within which to file the joint appendix and petitioners' briefs on the merits to and including August 2, 2004.
Aug 2 2004	Brief amicus curiae of National Federation of Independent Business Legal Foundation filed. VIDED.
Aug 2 2004	Joint appendix filed. VIDED.
Aug 2 2004	Brief of petitioners Claude M. Ballard and Mary B. Ballard filed.
Aug 2 2004	Brief amicus curiae of Leandra Lederman filed. VIDED.
Aug 2 2004	Brief amici curiae of David Pryor, et al. filed. VIDED.
Aug 25 2004	Extension of time within which to file respondent's brief on the merits to and including October 12, 2004.
Sep 29 2004	SET FOR ARGUMENT ON Tuesday, December 7, 2004.
Sep 30 2004	CIRCULATED.
Oct 12 2004	Brief of respondent Commissioner of Internal Revenue filed. VIDED. (Distributed)
Nov 5 2004	Record received from U.S.C.A. - 11th Circuit. (3 boxes and 1 envelope) (Tax Court reecord included)
Nov 16 2004	Reply of petitioners Claude M. Ballard and Mary B. Ballard filed. (Distributed)
Dec 7 2004	Argued. For petitioners: Stephen M. Shapiro, Chicago, Ill. For respondent: Thomas G. Hungar, Deputy Solicitor General, Department of Justice, Washington, D.C.

Supreme Court, U.S.
FILED

03 184 AUG 4 2003

In the

Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.,

Respondent.

On Petition for a Writ of Certiorari
to the United States Court
of Appeals for the Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In this case, the trial was conducted by a Special Trial Judge employed at will by the Tax Court. The Special Trial Judge was required to create a report of factual and legal findings, but his original report has never been made available to the parties, the public, or the reviewing Article III courts. Instead, his superiors on the Tax Court either overruled his factual findings or persuaded him to change his mind, thus creating a factual finding of tax fraud. This entire process took place off the record, and came to light only in a subsequent conversation between two Tax Court judges and a counsel for another party.

The questions presented are:

1. Whether this secretive process is consistent with the Due Process Clause or the right to effective Article III review?

2. Whether this secretive process is consistent with 26 U.S.C. § 7482, which provides that Article III courts must review Tax Court decisions just as they would decisions of a U.S. district court?

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PETITION FOR A WRIT OF CERTIORARI

Claude M. and Mary B. Ballard respectfully petition for a writ of certiorari to review the judgment of the Eleventh Circuit Court of Appeals in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. at 1a) is reported at 321 F.3d 1037 (CA11 2003). The opinion of the Tax Court (Pet. App. at 19a) is reported at *Investment Research Assocs., Ltd. v. Commissioner*, 1999 Tax Ct. Memo LEXIS 463, 78 T.C.M. (CCH) 951, T.C. Memo 1999-407 (1999).

JURISDICTION

The court of appeals issued its judgment on Feb. 13, 2003, and denied rehearing on May 5, 2003. Pet. App. 307a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and 26 U.S.C. § 7482(a)(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Constitution, Article III:

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.

U.S. Constitution, amend. V:

> No person shall . . . be deprived of life, liberty, or property, without due process of law.

26 U.S.C. § 7482(a)(1):

The United States Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . .

Tax Court Rule 183:

Except in cases subject to the provisions of Rule 182 or as otherwise provided, the following procedure shall be observed in cases tried before a Special Trial Judge:

(a) Trial and Briefs: A Special Trial Judge shall conduct the trial of any such case assigned for such purpose. After such trial, the parties shall submit their briefs in accordance with the provisions of Rule 151. Unless otherwise directed, no further briefs shall be filed.

(b) Special Trial Judge's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the Special Trial Judge shall submit a report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a Judge or Division of the Court.

(c) Action on the Report: The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact

recommended by the Special Trial Judge shall be presumed to be correct.

STATEMENT

The IRS alleged that Claude Ballard, a former Prudential real estate executive, committed fraud in various tax years by failing to report personal income. Pet. App. at 41a-42a. According to the IRS, the income in question was "earned" by Mr. Ballard as part of a complex scheme involving two of his friends: the late Burton Kanter, formerly a tax lawyer and law professor at the University of Chicago, and the late Robert Lisle, another real estate executive at Prudential. Pet. App. at 45a-49a. (The appeals of the other two taxpayers resulted in decisions from the Seventh Circuit and Fifth Circuit, as discussed below.)

The consolidated trial of Ballard and the other taxpayers took place over a five-week period in the summer of 1994. Under Tax Court Rule 183, the trial was conducted by a Special Trial Judge named Irwin Couvillion, who was the only judge to hear the witnesses and observe the evidence. Pet. App. at 33a. As a Special Trial Judge, Judge Couvillion has no tenure and is an at-will employee of the Tax Court. *See* 26 U.S.C. § 7443A(a) (providing for appointment of Special Trial Judges at discretion of Tax Court's Chief Judge).

Pursuant to Rule 183(b), Judge Couvillion spent some four years preparing a report of his factual findings and recommended legal conclusions. Uncontradicted record evidence shows that Judge Couvillion's original Rule 183 report included factual findings and credibility determinations that supported the Ballards' innocence and that it found the Ballards and the other parties *not guilty* of tax fraud or underreporting of income. The Rule 183 report was then filed with the Tax Court on September 2, 1998, after which the Chief Judge of the Tax Court assigned the case to

Judge Dawson, who later issued the opinion of the Tax Court. *Investment Research Assocs., Ltd. v. Commissioner*, 1999 Tax Ct. Memo LEXIS 463, 78 T.C.M. (CCH) 951 (1999).

The Tax Court's final opinion, however, found the Ballards (and the other taxpayers) *guilty* of underreporting income and of tax fraud for the years in question. Pet. App. at 265a-66a; 287a-89a; 294a-95a. By the Commissioner's concession at oral argument before the Eleventh and Seventh Circuits,[1] Judge Couvillion's original factual and legal findings had been *changed* under the influence of a Tax Court judge, who were not present at trial and who may or may not have reviewed the 6,000+ page transcript. Thus, what purports to be an opinion *adopting* Judge Couvillion's Rule 183 report, *see* Pet. App. at 33a, was actually an opinion *reversing* his original report.

The Tax Court had never, however, made the original Rule 183 report available to the parties or the public. The Ballards and the other taxpayers filed a series of motions asking that the original Rule 183 report be released, or in the alternative, that the original Rule 183 report be made part of the record for appellate review.[2] The Tax Court denied all these motions.[3]

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1 An audio recording of the *Kanter* oral argument can be found on the Seventh Circuit's website at http://www.ca7.uscourts.gov/farg/arg.fwx?caseno=01-4316&submit=showdkt&yr=01&num=. The Eleventh Circuit does not release transcripts to the parties, but this Court would presumably be allowed access to those materials.

2 In seeking the original Rule 183 report, the Ballards and the other taxpayers relied on an affidavit filed under penalty of perjury by Kanter's counsel, Randall Dick, in which Mr. Dick recounted a conversation in which two Tax Court judges revealed to him that Judge Couvillion's original report had been reversed. *See* Dick Affidavit, Pet. App. at 308a-10a.

3 On August 30, 2000, the Tax Court issued an order signed by Special Trial Judge Couvillion, Judge Dawson and the Chief Judge of the Tax Court denying the third and final motion. It stated:

> Judge Dawson states and Special Trial Judge Couvillion agrees, that, after a meticulous and time-consuming review of the complex record in these cases, Judge Dawson adopted the findings of fact and opinion of Special Trial Judge Couvillion, that Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and that Judge Dawson gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses.

T.C. Order of Aug. 30, 2000, Pet. App. at 315a.

Notably, however, the Tax Court *never* denied that Mr. Dick's affidavit was accurate, or that Judge Couvillion's original factual findings had been reversed at some point before issuance of the Tax Court's opinion. Nor did the Tax Court take any disciplinary action against Mr. Dick or accuse him of perjury, as it likely would have done had his affidavit been false or inaccurate in any material respect.

On July 24, 2001, Judge Dawson entered the final order of the Tax Court against the Ballards. An appeal was then taken to the Eleventh Circuit on October 17, 2001. Government counsel conceded at oral argument before the Eleventh Circuit that it had *no* evidence to support its original theory that Judge Couvillion had found fraud from the beginning. Instead, the government speculated – in a theory advanced for the first time at oral argument – that even if Judge Couvillion's original Rule 183 report found no fraud, he *later changed his mind* due to an off-the-record, *ex parte* discussion with his employers (*i.e.*, the reviewing judges on the Tax Court). Thus, when the Tax Court purported to "adopt" Judge Couvillion's opinion, it was technically correct in that Judge Couvillion had by then come to disagree with his original opinion.[4]

The Eleventh Circuit's decision was issued on February 13, 2003. *Ballard v. Commissioner*, 321 F.3d 1037 (CA11 2003) (Pet. App. at 1a). The court accepted the government's latest interpretation of this case's events, stating that "there is nothing unusual about judges conferring with one another about cases assigned to them,"

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4 Government counsel advanced the same novel theory in oral argument before the Seventh Circuit.

and that "as a result of such conferences, judges sometimes change their original position or thoughts." *Id.* at 1043. "Whether Special Trial Judge Couvillion prepared drafts of his report or subsequently changed his opinion entirely is without import insofar as our analysis of the alleged due process violation pertaining to the application of Rule 183 is concerned." *Id.*

A petition for rehearing was filed with the court of appeals on March 27, 2003. It was denied on May 5, 2003. Pet. App. at 307a.

Because appeals from Tax Court cases are taken to the circuit court of appeals in which the taxpayer resides, *see* 26 U.S.C. § 7482(b)(1)(A), the Kanter and Lisle appeals went to different circuit courts of appeals. On July 24, 2003, the Seventh Circuit issued its opinion in the companion case of *Estate of Burton W. Kanter v. Commissioner*, No. 01-4316, ___ F.3d ___ (CA7 July 24, 2003) (hereinafter "*Kanter* slip op."). In that opinion, the court found no due process violation in the Tax Court's withholding of the original Rule 183 report. A lengthy dissent by Judge Cudahy, however, argued that the Tax Court's unprecedented lack of transparency created a due process violation in regards to the parties' right to effective appellate review. *Kanter* slip op. at 75-103. Even though the court conducted its review without the benefit of access to the original Rule 183 report, it found the Tax Court's final opinion lacking in evidentiary support for one out of the six main factual issues. *Id.* at 73. An en banc petition is forthcoming in the Seventh Circuit.

The Lisle appeal resulted in a Fifth Circuit opinion that, despite lack of access to the original Rule 183 report exonerating the taxpayers, unanimously concluded that there was not sufficient evidence to conclude that Lisle committed tax fraud. *Estate of Robert W. Lisle v. Commissioner*, No. 01-60639, ___ F.3d ___ (CA5 July 30, 2003). While the Fifth Circuit attempts to avoid creating a direct circuit conflict by suggesting there are evidentiary distinctions between the cases, *id.* at 42 n.39, its holding

nonetheless unavoidably undermines the Tax Court's entire factual theory of the consolidated case, by which Ballard, Lisle, and Kanter supposedly participated in a unified conspiracy to split certain moneys in a 45-45-10 ratio. *See* Pet. App. 295a.

REASONS FOR GRANTING THE PETITION

It is undisputed that, by all the evidence present in the record for this case, Judge Couvillion's original Rule 183 report was changed, as government counsel conceded at oral argument before the Eleventh and Seventh Circuits. Yet the Tax Court has refused to officially notify either the parties or the reviewing Article III court that the result was changed, nor has it ever explained on the record why the fact-findings were changed or what standard of review was applied to the original fact-finder's decision.

The Eleventh Circuit's decision is the first in United States history to hold that because judges frequently discuss pending cases with their peers, they may also discuss and revise *fact-findings* off the record without advising the parties or the reviewing court of the change or providing any reasons for it. *Ballard*, 321 F.3d at 1043. *But see Kanter*, slip op. at 75-103 (Cudahy, J., dissenting). The error is compounded by the fact that in this case the judges are *not* peers, the trial judge is an at-will employee, and, under Rule 183, the employer judge is supposed to perform clear error review on the trial judge's findings. Whether or not Judge Couvillion agreed to change his factual findings, it is unprecedented to hold that a fact-finder (whether a Special Trial Judge, magistrate, jury, or other fact-finder) may confer *ex parte* and in secret with the very judges who are supposed to review the initial findings for clear error.

There are therefore two compelling reasons to grant a writ of certiorari in this case. First, the Tax Court's procedure "has so far departed from the accepted and usual courts of judicial proceedings . . . as to call for an exercise of

this Court's supervisory power." SUP. CT. R. 10(a); *Nguyen v. United States*, 123 S. Ct. 2130 (June 9, 2003).[5] Second, and relatedly, the Tax Court's procedure creates clashes with this Court's precedents as to Article III and the Due Process Clause.

I. The Questions Presented Are Of Manifest National Importance

The implications of this case stretch far beyond the Tax Court context. As Judge Cudahy noted, "If we approve the Tax Court's practice here, are we not suggesting to the whole administrative array of the federal government that it may seek . . . to deny transparency when engaging in like decisional processes?" *Kanter*, slip op. at 76 (Cudahy, J., dissenting).

If approved, the Tax Court's procedure would dramatically undermine the public's confidence in the fairness of the entire system of Article I courts and administrative agencies. *Cf. Nguyen*, 123 S. Ct. at 2139 n.17 (noting that allowing a non-Article-III judge to participate on a panel would "call into serious question the integrity as well as the public reputation of judicial proceedings"). Moreover, to leave the parties and reviewing courts with an incomplete record is a much more serious risk than the formalistic concerns at issue in *Nguyen*. In all cases handled by subordinate fact-finders, the American public should be assured that all fact-finding will be done on the record so that effective appellate review is possible.

Even in the context of Tax Court proceedings, this case is immensely important. Hundreds upon hundreds of

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[5] *See also Lehman Brothers v. Schein*, 416 U.S. 386, 393 (1974) (Rehnquist, J., concurring) ("The authority which Congress has granted this Court to review judgments of the courts of appeals undoubtedly vests us not only with the authority to correct errors of substantive law, but to prescribe the method by which those courts go about deciding the cases before them.").

taxpayers are subject to proceedings before Special Trial Judges, with no requirement that the parties consent (as is the case for trials before magistrates). Yet none of these taxpayers can be confident (1) that the Special Trial Judge's factual findings or credibility determinations will be given due respect; (2) that the Tax Court will perform its review function properly; or, (3) that the Article III review of that process will be effective or even available.

A LEXIS search reveals that between January 1, 1989 and June 25, 2003, there have been *765 reported cases* in which the Tax Court has employed a Special Trial Judge. The date 1989 is significant, because the former practice of the Tax Court *did* provide copies of the Special Trial Judge's report to the parties. This very practice is what made it possible for the parties in *Stone v. Commissioner*, 865 F.2d 342, 347-48 (CADC 1989), to convince the D.C. Circuit that the Tax Court had not correctly applied a clear error standard of review to the Special Trial Judge's initial report. But after that case, the Tax Court, for reasons that have *never been explained* to this date, stopped providing the Rule 183 reports of Special Trial Judges to anyone outside of its own judges and staff, thereby preventing any Article III review of its own review of Special Trial Judge decisions. Judge Cudahy has even suggested that the rule change may have occurred precisely so as to *discourage* appellate challenges, whether by taxpayers or the Commissioner. *Kanter*, slip op. at 85 (Cudahy, J., dissenting).[6]

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[6] Judge Cudahy was unable to discover any public record of the reasons for the rule change. This led him to observe, "Like the process by which an STJ's report is composed and then withheld, I find this rulemaking procedure oddly out of sync with prevailing practices in other areas of the law." *Kanter*, slip op. at 82 n.2 (Cudahy, J., dissenting). He further observed, "I must again note how remarkable it is that not only is the Tax Court unique in the opacity of its process, but it has arrived at this opaque process by abandoning a transparent process — an evolution completely counter to the trend towards transparency in analogous areas of the law." *Id.* at 85.

In *none* of these 765 cases since 1989 have the parties or the appellate courts been provided with a copy of the Special Trial Judge's original Rule 183 report. In every instance, the parties and the Article III courts of appeal are told only that the Tax Court "adopts" the report of the Special Trial Judge. Moreover, Petitioners have been unable, even after extensive searching, to find *any* case since 1989 in which the Tax Court indicated that it modified, altered, reversed, or changed the Special Trial Judge's conclusions in even the most minor respect. Judge Cudahy's research showed similar conclusions: "[I]n the 880-plus Tax Court decisions since 1983 that I could find that involved an STJ report, the Tax Court judge purported to agree with and adopt the opinion of the STJ in *every* instance. Never, in any instance since the adoption of the current Rule 183 that I could find, has a Tax Court judge *not* agreed with and adopted the STJ's opinion." *Kanter*, slip op. at 78 (Cudahy, J., dissenting).

Thus, as Judge Cudahy pointedly observed, "I say with confidence that this degree of unanimity is not only unusual, but impossible in a system of arms-length appellate style review involving 39 independent individuals." *Kanter*, slip op. at 79 (Cudahy, J., dissenting). It is starkly implausible that Special Trial Judges have, for the past 14 years, attained a record of 100% accuracy as to both the facts and the law. *This would be a feat unparalleled in the history of jurisprudence.* The only logical inference is that the Tax Court has continued, just as before 1989, to revise or alter or occasionally reverse the decisions of Special Trial Judges – but now without *ever* notifying the parties, the public, or the Article III court charged with reviewing the Tax Court's decisions.

II. The Tax Court's Structure of Adjudication Violates Due Process

A. The Balancing Test of *Mathews v. Eldridge* Requires Production of the Original Rule 183 Report

The Tax Court's refusal to produce the original Rule 183 report, even to the Eleventh Circuit, violates the famous test of *Mathews v. Eldridge*, 424 U.S. 319 (1976):

> [T]hree factors should be considered in determining whether the flexible concepts of due process have been satisfied: (a) the private interests implicated; (b) the risk of an erroneous determination by reason of the process accorded and the probable value of added procedural safeguards; and (c) the public interest and administrative burdens, including costs that the additional procedures would involve.

Id. at 333.

First, the Ballards have a significant private interest in receiving fair and trustworthy appellate review in a civil fraud case. As Judge Cudahy noted in his dissent, the "quasi-criminal nature of fraud is a more significant private interest than a simple civil determination . . ." *Kanter*, slip op. at 100 (Cudahy, J., dissenting). Moreover, even the Commissioner would in some cases have an interest in gaining access to the original and untouched Rule 183 report. Second, the risk of error is necessarily higher where the appellate court is forced to speculate about what the original fact-finder thought before his views were subject to lobbying or correction by his superiors. As Judge Cudahy said, "The precedents noted in the administrative context . . . clearly demonstrate how valuable preliminary findings are for review in cases like the present one." *Id.* Finally, the

additional cost would be exceedingly minimal - merely the cost of providing the original Rule 183 report to the parties.

The government has yet to claim any legitimate interest in keeping the original report secret. In Judge Cudahy's words, "[T]his entire process of the Tax Court appears designed to extract the efficiencies involved in designating cases to be heard by STJs without having to bear any of the procedural costs traditionally associated with this kind of adjunct decision-making (e.g., transparency)." *Kanter*, slip op. at 102 (Cudahy, J., dissenting).

In short, the three-part *Mathews* test indicates that the Tax Court's secrecy violates Due Process.

B. The Tax Court's Procedure Presumptively Violates the Due Process Clause

The Tax Court's procedure departs from the procedures used in every other state and federal court in America. This dramatic aberration gives rise to a presumptive Due Process violation.

It has long been the rule that a court's adherence to Due Process will be judged in large part by whether its practices are consistent with the rest of the American legal system. *See, e.g., Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 277 (1856) (holding that where American constitutional law provides no answer to a Due Process question, the court should look to the "settled usages and modes of proceeding existing in the common and statute law of England"); *Tumey v. Ohio*, 273 U.S. 510, 523 (1927) (same); *Powell v. Alabama*, 287 U.S. 45, 60-66 (1932) (conducting extensive analysis of colonial precedents related to the right to counsel).[7] "As this Court has stated from its

[7] *See also* Sanford H. Kadish, *Methodology and Criteria in Due Process Adjudication – A Survey and Criticism*, 66 YALE L.J. 319, 325-35 (1957) (discussing the Court's use of historical analysis in procedural due process cases).

first due process cases, traditional practice provides a touchstone for constitutional analysis." *Honda Motor Co. v. Oberg*, 512 U.S. 415, 430 (1994). "When the absent procedures would have provided protection against arbitrary and inaccurate adjudication, this Court has not hesitated to find the proceedings violative of due process." *Id.*[8]

Thus, for example, when the Court considered whether Due Process required that criminal violations be proved beyond a reasonable doubt, the Court found that American judicial system's "virtually unanimous adherence" to this standard reflected a "profound judgment about the way in which law should be enforced and justice administered." *In re Winship*, 397 U.S. 358, 362 (1970) (quoting *Duncan v. Louisiana*, 391 U.S. 145, 155 (1968)). In *Duncan*, the Court found a Due Process violation where one state departed from the universal practice of allowing jury trials for serious criminal offenses. 391 U.S. at 155. Similarly, in *Oberg*, the Court held that Oregon had denied Due Process by disallowing any appellate scrutiny of the size of punitive damage awards, basing its holding on the fact that appellate scrutiny was permitted in the federal system and in every state except Oregon. *Oberg*, 512 U.S. at 430.

[8] The opposite is true as well: Where plaintiffs challenge procedures that have been universally deployed, the Court is reluctant to find a Due Process violation. *See, e.g., Burnham v. Superior Court of Cal., County of Marin*, 495 U.S. 604, 611-16 (1990); *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 17 (1991) (noting that "every state and federal court that has considered the question has ruled that the common-law method for assessing punitive damages does not in itself violate due process"); *Sun Oil Co. v. Wortman*, 486 U.S. 717, 730 (1988) ("'If a thing has been practised for two hundred years by common consent, it will need a strong case for the Fourteenth Amendment to affect it.'") (quoting *Jackman v. Rosenbaum Co.*, 260 U.S. 22, 31 (1922)); *Snyder v. Massachusetts*, 291 U.S. 97, 111 (1934) ("The Fourteenth Amendment has not displaced the procedure of the ages").

As discussed in detail below, the Tax Court's procedure departs in many ways from those used in every other court: It keeps the initial fact-finder's report, the communications relating to it, and any reasons for change, off the record and unavailable to the parties or reviewing courts; it allows the reversal of credibility findings by someone not present at trial; and it allows off the record, *ex parte* contact between a reviewing superior and the putative fact-finder.[9] As Judge Cudahy said in his dissent, the Tax Court avoids "procedural transparency in a circumstance where *every other like process* known to the law is transparent." *Kanter*, slip op. at 76 (Cudahy, J., dissenting) (emphasis added). The Tax Court's practice thus presumptively violates the Due Process Clause.[10]

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9 To be sure, the denial of a traditional procedural safeguard may be excused where the court has adopted an adequate substitute procedure. *Oberg*, 512 U.S. at 430-31. But the Tax Court has not even purported to adopt any procedure that would be an adequate substitute for the traditional practice by which the factfinder's conclusions are, at the very least, made public before they are subject to correction or review by a superior officer.

10 Respondent might point to the fact that there exist few, if any, Due Process precedents that are precisely on point with the current case. Yet this very lack of precedent is further confirmatory evidence that Due Process has been violated. The Court in *Oberg* observed that "[b]ecause the basic procedural protections of the common law have been regarded as so fundamental, very few cases have arisen in which a party has complained of their denial." *Oberg*, 512 U.S. at 430. Similarly, the Court observed in *Burnham* that the reason some jurisdictions lacked precedents on a particular Due Process issue was "because the issue was so well settled that it went unlitigated." *Burnham*, 495 U.S. at 613.

The present case involves principles of similarly unanimous lineage. The reason that there are few direct precedents for Petitioners' argument is precisely because the Tax Court's own practice is without precedent.

1. The Decision Below Conflicts With The Universal Rule That Fact-Finding Must Be Made On The Record

Throughout the entire American court system, fact-finders (whether juries, district judges, administrative law judges, magistrates, or special masters) always make their initial factual findings on the record, whether or not those findings are later subject to change or review.

Juries, for example, always announce their verdict in public *before* the judge can even consider issuing a judgment as a matter of law under FED. R. CIV. P. 50 or any analogous state procedural rule. When federal district courts employ magistrates under 28 U.S.C. § 631 to conduct factual hearings, the magistrates must submit their proposed findings and recommendations for disposition to the Court *and to the parties*. 28 U.S.C. § 636(b)(1)(c) ("[T]he magistrate shall file his proposed findings and recommendations under subparagraph (B) with the court and a copy shall forthwith be mailed to all parties."); *see also* FED. R. CIV. P. 72 and 73.

When federal district courts employ special masters, the rule is the same: the special master must make and file a report, as well as serve it on the parties, FED. R. CIV. P. 53(e)(1), and his factual conclusions can only be disturbed for clear error, *id.* 53(e)(2); *see also* 9A WRIGHT & MILLER, FEDERAL PRACTICE & PROCEDURE § 2614 (2d ed. 1995).[11] And where a bankruptcy judge makes factual findings, these findings are available on the record to the parties and the public before they are reviewed by a federal district judge. *See* STEVEN ALAN CHILDRESS & MARTHA S. DAVIS, 1 FEDERAL STANDARDS OF REVIEW, at § 2.03E (1999).

Similarly, although the factual findings of administrative law judges are subject to review by their

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11 This has long been the rule. *See, e.g., Tilghman v. Proctor*, 125 U.S. 136, 149-50 (1888) (considering exceptions taken to master's factual report); *Callaghan v. Myers*, 128 U.S. 617, 666-67 (1888) (same).

superiors, the original findings are still part of the administrative record. 5 U.S.C. § 557(c) ("All decisions, *including initial, recommended, and tentative decisions*, are a part of the record and shall include a statement of--(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record. . . .") (emphasis added).[12]

Thus, in the famous case of *Universal Camera v. NLRB*, 340 U.S. 474 (1951), this Court held that in order to perform "substantial evidence" review of the NLRB's determination, Article III courts had to be able to consider the hearing examiner's *initial report*, even though in that context a statute actually required the "Board" itself to make factual findings. *See* 29 U.S.C. § 160(c). In the Court's words, "[S]urely an examiner's report is as much a part of the record as the complaint or live testimony." *Id.* at 493. "[E]vidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn [different] conclusions . . . ." *Id.* at 496.

In sharp contrast to the procedures used in other courts, the Tax Court has refused to make public the original Rule 183 report as filed by Judge Couvillion. The Commissioner's counsel even refused, in the *Kanter* case, to provide a straight answer to a Seventh Circuit judge's question whether the Commissioner would supply that court with a sealed copy of Judge Couvillion's original Rule

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12 Agencies are also forbidden to promulgate rules based on comments or evidence that are kept secret. *See, e.g., Home Box Office, Inc. v. F.C.C.*, 567 F.2d 9, 56 (CADC 1977) ("Equally important is the inconsistency of secrecy with fundamental notions of fairness implicit in due process and with the ideal of reasoned decisionmaking on the merits which undergirds all of our administrative law."); 42 U.S.C. § 7607(d)(6)(C) (Clean Air Act requirement that "(t)he promulgated rule may not be based (in part or whole) on any information or data which has not been placed in the docket . . . .").

183 report - even after the judge explicitly asked to be given a "yes or no" answer.[13]

Fact-finding *on the record* is an indispensable part of our judicial system. The Tax Court's practice conflicts with the practice of every other court in America, and should be struck down.

2. The Decision Below Conflicts With The Universal Rule That Credibility Findings Should Rarely, If Ever, Be Reversed By Someone Who Was Not Present At Trial

The opportunity to observe a witness is necessary to make a meaningful credibility determination. Credibility findings are particularly important in this case, which involved dozens of witnesses, weeks of testimony, and thousands of pages of transcript. As Judge Cudahy said, "I can think of no single item of more significance in evaluating a Tax Court's decision on fraud than the unfiltered findings of the STJ who stood watch over the trial." *Kanter*, slip op. at 99 (Cudahy, J., dissenting).

Because of the fact-finder's unique proximity to the live testimony, his or her decision is always subject to a deferential standard of review, whether he wears the title "judge," "juror" or "special trial judge." It is universally accepted that credibility assessments can only rarely be second-guessed by those who were not present.[14] As this Court stated in *Anderson v. City of Bessemer*, 470 U.S. 564 (1985): "When findings are based on determinations regarding the credibility of witnesses, . . . only the trial judge can be aware of the variations in demeanor and tone of voice that bear so heavily on the listener's understanding of and belief in what is said." *Id.* at 575. "[W]hen a trial judge's

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13 *Kanter* oral argument, *supra* note 1.

14 This is true in all fifty states as well. *See* 5 C.J.S. *Appeal and Error* § 781 (1993).

finding is based on his decision to credit the testimony of one of two or more witnesses, each of whom has told a coherent and facially plausible story that is not contradicted by extrinsic evidence, that finding, if not internally inconsistent, can virtually never be clear error." *Id.*[15]

Thus, in jury trials, a judgment as a matter of law can be rendered against a party only if "there is no legally sufficient evidentiary basis for a reasonable jury to find for that party on that issue." FED. R. CIV. P. 50(a). In bench trials, fact-findings may not be set aside "unless clearly erroneous." FED. R. CIV. P. 52.

Similarly, in *United States v. Raddatz*, 447 U.S. 667 (1980), this Court upheld the constitutionality of the

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[15] *See also Universal Camera*, 340 U.S. at 496 ("The significance of [the hearing examiner's] report, of course, depends largely on the importance of credibility of witnesses."); *Holiday v. Johnston*, 313 U.S. 342, 352 (1941) ("One of the essential elements of the determination of the crucial facts [in any case] is the weighing and appraising of testimony."); *Morgan v. United States*, 298 U.S. 468, 481 (1936) ("That duty cannot be performed by one who has not considered evidence or argument. . . . The one who decides must hear."); *Gottlieb v. Barry*, 43 F.3d 474, 486-87 & n.9 (CA10 1994) (holding that district court must respect a master's determination if it is "similar to a credibility finding"); *United States v. Marshall*, 609 F.2d 152, 155 (CA5 1980) (only in a "rare case" should a district judge resolve credibility choices in manner contrary to recommendation of magistrate who heard witnesses' testimony); *Bennerson v. Joseph*, 583 F.2d 633, 641 (CA3 1978) (district court serves in a reviewing capacity and should not displace master's view of witnesses' credibility); *National R.R. Passenger Corp. v. Koch Indus., Inc.*, 701 F.2d 108, 111 (CA10 1983) (discussing importance of respecting a master's determinations that are "similar to a credibility finding").

For the same reason, where a case has been tried to the bench and the judge who heard the case below is no longer available on remand, the new judge will normally be required to recall and hear each of the witnesses himself. *See, e.g., United States v. Mitchell*, 187 F.3d 331, 332-33 (CA3 1999) ("Because on remand this case must be assigned to a district judge who had not had the opportunity to observe the witnesses either at trial or at the sentencing hearing, we believe that it is better procedure to direct a full sentencing hearing.").

Magistrate's Act only because there was no reason to believe that credibility determinations had been *rejected*. In that case, a federal District Judge had upheld a magistrate's finding that a criminal defendant had confessed voluntarily. In doing so, the Judge had not recalled the witnesses to repeat their testimony. In rejecting due process and Article III objections, a plurality of the Court explicitly noted that the situation would be very different had the District Court *rejected* a magistrate's fact-finding without personally observing the witnesses:

> Neither the statute nor its legislative history reveals any specific consideration of the situation where a district judge after reviewing the record in the process of making a *de novo* "determination" has doubts concerning the credibility findings of the magistrate. The issue is not before us, but we assume it is unlikely that a district judge would reject a magistrate's proposed findings on credibility when those findings are dispositive and substitute the judge's own appraisal; *to do so without seeing and hearing the witness or witnesses whose credibility is in question could well give rise to serious questions* which we do not reach.

Id. at 681 n.7 (emphasis added).[16]

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[16] Indeed, this concern was not only noted by the plurality, it was the central feature of all of the concurring and dissenting opinions. *See id.* at 684 (Blackmun, J., concurring) ("I would distinguish between instances where the district court rejects the credibility-based determination of a magistrate and instances, such as this one, where the court adopts a magistrate's proposed result."); *Id.* at 686-87 (Powell, J., concurring in part and dissenting in part) (arguing that where credibility issues are concerned, the Article III judge must conduct his own hearing of the witnesses whether or not he wishes to reverse the magistrate); *Id.* at 691 (Stewart, J., joined by JJ. Brennan and Marshall) (arguing that the district judge could *never* decide a motion to suppress "without being exposed to the one kind of

A subsequent case confirmed the Court's continuing concern over reversals of credibility determinations. In *Peretz v. United States*, 501 U.S. 923 (1991), the issue was whether a magistrate could lawfully conduct voir dire proceedings in a felony trial. The Court noted that in some cases, the magistrate's determination might "turn[] on the credibility of witnesses." *Id.*at 939. To answer this observation, the Court cited footnote 17 from *Raddatz*: "We presume, as we did in *Raddatz* when we upheld the provision allowing reference to a magistrate of suppression motions, that district judges will handle such cases [i.e., cases hinging on credibility findings] properly if and when they arise. See *id.*, at 681, n. 7." *Id.* In other words, the *Peretz* Court, just as in *Raddatz*, heavily implied that district courts are expected to respect credibility determinations made by magistrates, and indicated that the constitutionality of allowing magistrates in the first place might hinge on such respect being accorded their determinations.

In short, it is the universal practice of American courts that credibility determinations made by a fact-finder, whether a judge or jury, are to be given great respect and are rarely, if ever, to be overruled by another judge who was not present at trial. Yet here the results found by Special Trial Judge Couvillion were changed by or under the influence of Judge Dawson, who was not present at trial and did not observe the witnesses. This Court should not countenance such a departure from traditional procedures of fact-finding.

3. The Decision Below Conflicts With The Universal Prohibition Against *Ex Parte* Contact With The Fact-Finder

In the federal system, trial judges must not discuss fact issues with the jurors before the verdict has been

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evidence that no written record can ever reveal -- the demeanor of the witnesses.").

announced. *See, e.g., United States v. United States Gypsum Co.*, 438 U.S. 422, 460 (1978) ("Any *ex parte* meeting or communication between the judge and the foreman of a deliberating jury is pregnant with possibilities for error."); *Rogers v. United States*, 422 U.S. 35, 38 (1975) (reversing conviction where judge engaged in *ex parte* communications with jurors); *United States v. Cowan*, 819 F.2d 89, 93-94 (CA5 1987) (same); *Fillippon v. Albion Vein Slate Co.*, 250 U.S. 76, 81 (1919) (same); *United States v. Yonn*, 702 F.2d 1341, 1345 (CA11 1983) (discussing significance of adequate record to access role of *ex parte* contact). This prohibition is rooted firmly in due process considerations. *See, e.g., United States v. Frazin*, 780 F.2d 1461, 1469 (CA9 1986) ("*Ex parte* communications from the judge to the jury violate a defendant's right to due process of law.").

Similarly, *every* state judicial system (by rule or court decision) has also prohibited *ex parte* communications between judges and jurors while fact issues are in play.[17]

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[17] *Matthews v. Liberty Mut. Ins. Co.*, 243 So. 2d 703 (Ala. 1971); *Frontier Cos. v. Jack White Co.*, 818 P.2d 645 (Alaska 1991); *Perkins v. Komarnyckyj*, 834 P.2d 1260 (Ariz. 1992); *Coran v. Keller*, 748 S.W.2d 349 (Ark. 1988); *Halada v. Venice Lake Park, Inc.*, 283 P.2d 42 (Cal. Ct. App. 1955); *Kimmins v. City of Montrose*, 151 P. 434 (Colo. 1915); *Aillon v. State*, 363 A.2d 49 (Conn. 1975); *Loatman v. Patillo*, 401 A.2d 91 (Del. 1979); *Sears Roebuck & Co. v. Polchinski*, 636 So. 2d 1369 (Fla. Dist. Ct. App. 1994); *Gibson v. Gibson*, 187 S.E. 155 (Ga. Ct. App. 1936); *State v. Estrada*, 738 P.2d 812 (Haw. 1987); *Rueth v. State*, 596 P.2d 75 (Idaho 1978); *Gale v. Hoekstra*, 375 N.E.2d 456 (Ill. App. Ct. 1978); *Rogers v. R.J. Reynolds Tobacco Co.*, 745 N.E.2d 793 (Ind. 2001); *Ragee v. Archbold Ladder Co.*, 471 N.W.2d 794 (Iowa 1991); *Scales v. St. Louis-San Francisco Ry.*, 582 P.2d 300 (Kan. Ct. App. 1978); *Goode v. Campbell*, 77 Ky. 75 (1878); *Jones v. Black*, 676 So. 2d 1067 (La. 1996); *Greely v. Weaver*, 5 A. 267 (Me. 1886); *Smith v. State*, 505 A.2d 564 (Md. Ct. Spec. App. 1986); *Commonwealth v. DeJesus*, 691 N.E.2d 234 (Mass. Pet. Ct. 1998); *People v. France*, 461 N.W.2d 621 (Mich. 1990); *Booth v. Spindler*, 110 N.W.2d 889 (Minn. 1961); *Boedges v. Dinges*, 428 S.W.2d 930 (Mo. Ct. App. 1968); *Gulf Hills Dude Ranch, Inc. v. Brinson*, 191 So. 2d 856 (Miss. 1966); *State Highway Comm'n v. Dunks*, 531 P.2d 1316 (Mont. 1975); *Taulborg v. Andresen*, 228 N.W. 528 (Neb. 1930); *Isbell v. State*, 626 P.2d 1274 (Nev. 1981); *State v. Bailey*, 503 A.2d 762 (N.H. 1985);

Indeed, state courts often take the view that such conduct is both reversible without objection,[18] and so serious that harm is to be presumed.[19]

The rule is the same in the administrative context, where all *ex parte* contact with an administrative law judge is forbidden, *see* 5 U.S.C. § 557(d) (forbidding *ex parte* contact); *Town of Orangetown v. Ruckelshaus*, 740 F.2d 185, 188 (CA2 1984) ("where agency action resembles judicial action, . . . the insulation of the decisionmaker from *ex parte* contacts is justified by basic notions of due process to the parties involved.") (quoting *Sierra Club v. Costle*, 657 F.2d 298, 400 (CADC 1981)).

In short, all American courts and other tribunals follow the general rule that any person or entity charged with making factual findings must not be subject to any *ex parte* contacts that are designed to influence the outcome of that fact-finding mission. In this case, however, it is

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Guzzi v. Jersey Cent. Power & Light Co., 115 A.2d 629 (N.J. Super. Ct. App. Div. 1955); *Amador v. Lara*, 603 P.2d 310 (N.M. Ct. App. 1979); *Linke v. Savage*, 333 N.Y.S.2d 600 (N.Y. App. Div. 1972); *Sheff v. Conoco, Inc.*, 311 S.E.2d 14 (N.C. Ct. App. 1984); *Kronberger v. Zins*, 463 N.W.2d 656 (N.D. 1990); *Bostic v. Connor*, 524 N.E.2d 881 (Ohio 1988); *Osage Mercantile Co. v. Harris*, 152 P. 408 (Okla. 1915); *Hastings v. Top Cut Feedlots, Inc.*, 590 P.2d 1210 (Or. 1979); *Glendenning v. Sprowls*, 174 A.2d 865 (Pa. 1961); *Amica Mut. Ins. Co. v. Tashjian*, 703 A.2d 93 (R.I. 1997); *State v. Dawkins*, 232 S.E.2d 228 (S.C. 1977); *Gilbert v. Caffee*, 293 N.W.2d 893 (S.D. 1980); *Guy v. Vieth*, 754 S.W.2d 601 (Tenn. 1988); *Conrey v. McGehee*, 473 S.W.2d 617 (Tex. Civ. App.-Houston [14th Dist.] 1971, writ ref'd n.r.e.); *Johnson v. Maynard*, 342 P.2d 884 (Utah 1959); *State v. Loso*, 559 A.2d 681 (Vt. 1989); *Ellis v. Commonwealth*, 317 S.E.2d 479 (Va. 1984); *Iverson v. Pacific Am. Fisheries*, 442 P.2d 243 (Wash. 1968); *Klesser v. Stone*, 201 S.E.2d 269. (W.Va. 1973); *State v. Burton*, 334 N.W.2d 263 (Wis. 1983); *Carlson v. Carlson*, 888 P.2d 210 (Wyo. 1995).

[18] *Smith v. State*, 505 A.2d 564 (Md. Ct. Spec. App. 1986); *People v. France*, 461 N.W.2d 621 (Mich. 1990).

[19] *Rogers v. R.J. Reynolds Tobacco Co.*, 745 N.E.2d 793 (Ind. 2001); *Glendenning v. Sprowls*, 174 A.2d 865 (Pa. 1961); *Guy v. Vieth*, 754 S.W.2d 601 (Tenn. 1988).

uncontested (even by the Commissioner's and the Eleventh Circuit's theory) that various judges of the Tax Court had *ex parte* contacts with Judge Couvillion behind the scenes, off the record, and before any official fact-findings were released to the public.

It is as if a district judge were to accompany a jury during their deliberations and urge them to change their mind on the outcome of the case - all without letting the jury's original and unvarnished thoughts on the factual issues ever be made known. Such a procedure would invariably and unnecessarily give rise to speculation about the legitimacy of the ultimate decision. *Cf. Nguyen*, 123 S. Ct. at 2139 n.17 (noting that allowing a non-Article-III judge to participate on a panel would "call into serious question the integrity as well as the public reputation of judicial proceedings"). No reviewing court would tolerate such a drastic departure from traditional practices. This Court should not tolerate it here.

III. The Original Set Of Fact-Findings Must Be Made Available To The Reviewing Court In Order To Satisfy Article III and 26 U.S.C. § 7482

All parties who come into conflict with the federal government have a right to effective review by an Article III court. Even in so-called "public rights" cases, this Court has upheld the use of Article I courts *only* insofar as the private parties have been given the statutory right to appeal to an Article III court. *See, e.g., Crowell v. Benson*, 285 U.S. 22, 54 (1932) (upholding Article I adjudication of claims under Longshoremen's and Harbor Workers' Act because review by Article III court was possible); *Thomas v. Union Carbide Agricultural Prods. Co.*, 473 U.S. 568, 592 (1985) (upholding Article I adjudication of FIFRA claims because "FIFRA at a minimum allows private parties to secure Article III review of the arbitrator's 'findings and determination' for fraud, misconduct, or misrepresentation."); *Northern Pipeline*

Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 85 (1982) (holding that Article III review of the bankruptcy court under the "clearly erroneous" standard was not rigorous enough to save the statute); *Id.* at 70 n.23 (noting that "[even] when Congress assigns ['public rights'] matters to administrative agencies, or to legislative courts, it has generally provided, and we have suggested it may be required to provide, for Article III judicial review"); *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 853 (1986) (upholding a CFTC adjudicatory scheme after noting that Congress permitted meaningful judicial review).[20]

Effective Article III review requires that the appellate court be able to know what the original and unvarnished factual findings were, as made by the person who conducted the trial. Without a record of a jury's unrevised verdict, for example, no appellate court could possibly conduct an effective review of a trial judge's grant of judgment as a matter of law. This principle is so obvious that citations are unavailable: Before the Tax Court's change in practice in the 1980s, no American court had attempted to keep original fact-findings secret. As Judge Cudahy said, "No court of which I am aware has ever considered the ramifications of an agency's swallowing and refusing to regurgitate a preliminary factual finding in the manner done by the Tax Court here." *Kanter*, slip op. at 99 (Cudahy, J., dissenting).

The statutory requirement applicable to review of Tax Court decisions is similar. Section 7482 of the Internal Revenue Code specifically provides that the courts of appeals are to "review the decisions of the Tax Court . . . *in*

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20 *See also* Richard H. Fallon, *Of Legislative Courts, Administrative Agencies, and Article III*, 101 HARV. L. REV. 916 (1988) (concluding that meaningful judicial review in an Article III court is required by the Constitution); Richard B. Saphire & Michael E. Solimine, *Shoring Up Article III: Legislative Court Doctrine in the Post* CFTC v. Schor *Era*, 68 B.U. L. REV. 85 (1988) (asserting that judicial review by an Article III court is a necessary but insufficient requirement of any delegation of judicial power).

the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . . ." *See* 26 U.S.C. § 7482 (emphasis added).

It is beyond dispute that when the courts of appeals review decisions of "district courts in civil actions tried without a jury," they are able to examine the actual fact findings of the district court or any subordinate fact-finder. Under Rule 52 of the Federal Rules of Civil Procedure, the district judge must "find the facts specially and state separately its conclusions of law thereon." Paralleling Tax Court's Rule 183, Rule 52 also requires that "[f]indings of fact . . . shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial to judge of the credibility of the witnesses."

Where a district judge has employed the services of a magistrate or special master in a bench trial, no appellate court would tolerate the district judge's attempt to revise or manipulate the factual findings behind the scenes, without ever letting the appellate court know what the original findings were. It would also be impossible for a district judge simply to keep the master's original findings secret, whether or not those findings had ever been changed. Such actions would be inconceivable, and would make effective appellate review impossible.[21] *Cf. Universal Camera*, 340 U.S.

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21 Indeed, there has long been a debate over what standard of review should be applied by the appellate court where a district court has disagreed with another fact-finder (such as a master). *See Stone*, 865 F.2d at 347-48 (discussing the conflict); STEVEN ALAN CHILDRESS & MARTHA S. DAVIS, 1 FEDERAL STANDARDS OF REVIEW, at § 2.03C (1999) (same). Most courts have held that the appellate court should ignore the intermediate step (i.e., the district court) and review the original fact-finder's results *directly*. *See, e.g., Morris Plan Industrial Bank v. Henderson*, 131 F.2d 975 (CA2 1942) (Hand, J.); *Gottlieb*, 43 F.3d at 486-87 & n.9; *Cook v. Niedert*, 142 F.3d 1004, 1009-12 (CA7 1998); *In re Multiponics, Inc.*, 622 F.2d 709, 723 (CA5 1980); *O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1, 4-5 (CA8 1961); *Lines v. Falstaff Brewing Co.*, 233 F.2d 927, 930 (CA9 1956). A few courts, on the other hand, have given more deference to the district court's views. *See, e.g., Milliken Research Corp. v. Dan River, Inc.*, 739 F.2d 587, 592-93 (Fed. Cir. 1984);

at 493 ("[S]urely an examiner's report is as much a part of the record as the complaint or live testimony.").

In *Stone v. Commissioner*, 865 F.2d 342 (CADC 1989), the D.C. Circuit held that the combination of Section 7482 and Tax Court Rule 183 (then labeled Rule 182) required 1) the Tax Court to apply a clear error standard of review to the Special Trial Judge's findings, and 2) the court of appeals to apply clear error review to the Tax Court's own review process. *Id.* at 348. The court said:

> If a simple "preponderance" of the evidence -- half plus a little bit -- suffices to overturn the factual findings of a Special Trial Judge, then it is difficult to see what value or force attaches to the presumptive correctness of that judge's factual determinations, much less the "due regard" owed "to the circumstance that the [Special Trial Judge] had the opportunity to evaluate the credibility of witnesses."

Id. at 347.

In other words, when an Article III court of appeals is reviewing a Tax Court decision, it must assure itself that the Tax Court has not committed any clear error in its own review of the Special Trial Judge's original report. This sort of Article III review is absolutely impossible, however, where the Tax Court refuses to let the court of appeals view the original Rule 183 report. While the Special Trial Judge was the only person in a position to make credibility determinations in a fraud case involving 55 witnesses, the Tax Court refused to make the initial findings of Judge

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United States v. Twin City Power Co., 248 F.2d 108, 112 (CA4 1957). Crucially, however, this entire debate would be absolutely impossible unless everyone took for granted that the appellate court must, at the very least, be informed of what the original fact-finder's conclusions were.

Couvillion available to the Eleventh Circuit, even on a sealed basis. The Tax Court simply declared that "Judge Dawson gave *due regard* to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses." T.C. Order, Pet. App. at 315a (emphasis added). But how much "regard" did Judge Dawson actually give to Judge Couvillion's actual credibility findings (which remain unpublished to this day)? Did he apply the clear error standard? Did he apply that standard correctly? Did he make contrary credibility assessments? If he did, was his assessment based on something that appeared in the record or something else? None of these questions can be answered.

Thus, while Congress and the Constitution have given taxpayers the right to have their case reviewed by Article III judges "in the same manner and to the same extent as decisions of the district courts in civil cases tried without a jury," 26 U.S.C. § 7482, that review cannot meaningfully occur when the Tax Court hides evidence that in any other court would be part of the public record. The Tax Court's procedure is neither what Congress intended, nor what Article III would permit.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully Submitted,

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(any footnotes trail end of each document)

CLAUDE M. BALLARD and MARY B. BALLARD, Petitioners-Appellants, versus COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Nos. 01-17249, 01-17251, 01-17253, 01-17255, 01-17256, 01-17257

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

February 13, 2003, Decided

February 13, 2003, Filed

COUNSEL: For Ballard, Claude M., Ballard, Mary B., Appellants (01-17249-GG, 01-17251-GG, 01-17253-GG, 01-17255-GG, 01-17256-GG, 01-17257-GG): Davis, Robert Edwin, Hughes & Luce, LLP, Dallas, TX. Brown, Steven Spencer, Martin, Brown & Sullivan, Ltd., Chicago, IL. Hughes, Vester T., Jr., Hughes & Luce, L.L.P., Dallas, TX. Schenck, David J., Hughes & Luce, LLP, Dallas, TX. Martin, Royal B., Jr., Martin, Brown & Sullivan, Ltd., Chicago, IL.

For Commissioner of Internal Revenue, Appellee (01-17249-GG, 01-17251-GG, 01-17253-GG, 01-17255-GG, 01-17256-GG, 01-17257-GG): Openheimer, Joan I., Washington, DC.

JUDGES: Before HULL, FAY and GIBSON *, Circuit Judges.

OPINIONBY: FAY

OPINION: FAY, Circuit Judge:

Petitioners-Appellants Claude M. Ballard ("Ballard") and Mary B. Ballard n1 appeal the judgment of the United States

Tax Court in which it found that Ballard fraudulently failed to declare and pay income tax on approximately $ 3,200,000. The Tax Court determined that Ballard earned the unreported income through a scheme with Burton W. Kanter ("Kanter") and Robert W. Lisle ("Lisle") to sell influence with Prudential Life Insurance Co. of America ("Prudential") whereby suitors of Prudential would pay Kanter kickbacks in exchange for the influence of Ballard and Lisle, senior Prudential employees. After receipt of the kickback proceeds, Kanter would funnel the proceeds of the scheme to Ballard and Lisle through a complex web of corporations, partnerships and trusts designed to shelter the money from the reporting requirements of the Internal Revenue Code. As a result of the Tax Court's findings, Petitioners-Appellants have been assessed tax deficiencies (including penalties against Ballard) totaling $ 1,318,648.

On appeal, Petitioners-Appellants assert (1) that application of Tax Court Rules of Practice and Procedure Rule ("Rule") 183, which allowed the Tax Court Judge to review the findings of the Special Trial Judge without making the findings of the Special Trial Judge available to the parties, violated their due process rights, and (2) that the evidence adduced at trial is insufficient to support the Tax Court's findings. After extensive review of the record and consideration of oral argument, we find that the application of Rule 183 did not violate Petitioners-Appellants' due process rights and that the evidence is sufficient to support the Tax Court's finding that Ballard received and fraudulently failed to report income.

I. BACKGROUND

A. Facts

The factual underpinning of the case involves allegations by the Internal Revenue Service ("IRS") that Ballard and Lisle sold influence with Prudential's Real Estate Department to

would-be Prudential suitors via Kanter, a well-known tax attorney and University of Chicago Law School professor. Ballard worked for Prudential from 1948 until 1981, and Lisle worked for Prudential from 1950 until 1982. Both Ballard and Lisle worked in Prudential's real estate department which was divided into two divisions: equity operations and mortgage operations. During the years of Ballard's and Lisle's employment, Prudential was one of the largest owners of commercial real estate in the United States. Ballard worked in the equity operations division, ultimately becoming the senior vice-president responsible for all operations, acquisitions, sales and portfolio management of Prudential's equity investments in real estate. Ballard's position afforded him great influence over the choice of builders and contractors for Prudential projects and, resultantly, he could influence or prevent a project from going forward. Lisle worked in Prudential's mortgage operations division, ultimately becoming a vice-president and overseeing the lending of money and buying and building of real estate for Prudential. Lisle had the authority to commit any loan up to $ 20,000,000 and to award construction contracts.

Ballard and Lisle worked out of Prudential's Newark, New Jersey corporate headquarters. In fact, their offices were located next to one another. Further, both Ballard and Lisle worked under Donald Knab ("Knab"), the person in charge of all of Prudential's real estate operations. Knab highly regarded both Ballard's and Lisle's work. Consequently, Ballard and Lisle had great influence with Knab regarding the projects Prudential would pursue.

Ballard and Lisle met Kanter during the early 1970s and they all quickly became personal friends. Thereafter, as the IRS contends, Ballard, Lisle and Kanter proceeded to engage in a

scheme whereby Prudential suitors would pay kickbacks to Kanter for securing Prudential business. Because Kanter himself had no influence over Prudential, in order to secure Prudential business, Kanter would rely on Ballard and Lisle. Specifically, the IRS contends that on five separate occasions, arrangements were made to buy Ballard's and Lisle's influence. n2 For each of these arrangements, following the receipt of kickback proceeds, Kanter would funnel the money to Ballard through a complex web of corporations, partnerships and trusts. As alleged by the IRS, Ballard ultimately would receive kickback proceeds through a number of means including deposit of the funds by Kanter into a corporation completely controlled by Ballard, through sham loans by Kanter to Ballard, or through sham consultant payments to Ballard's family members. n3

As the IRS asserts, in order to facilitate the scheme, Kanter formed Investment Research Associates, Ltd. ("IRA") n4 which acted as the conduit through which all kickback proceeds to Ballard were funneled. IRA itself did not perform any business, had no employees other than bookkeepers and paid no salaries in any years other than minimal amounts from 1979 to 1982. However, IRA did have a controlling interest in various subsidiaries including TMT, Inc. ("TMT"), Carlco, Inc. ("Carlco") and BWK, Inc. ("BWK"). n5

TMT was formed in 1982 and remained inactive until IRA acquired all of its outstanding shares of common stock at the end of 1983. At [*7] that time, TMT issued 150 preferred shares of stock to Ballard's family trust ("the Orient Trust") and in 1984, TMT issued an additional 150 shares of preferred stock to the Orient Trust. The IRS contends that TMT was the personal pocketbook of Ballard exhibited by Ballard's complete control over TMT and its investment decisions as well as the fact that Ballard and his family had signatory authority over TMT's accounts and that TMT's

designated business address was Ballard's personal residence.

By the end of 1983, the IRS contends that IRA had accumulated $ 4,771,445 in payments related to "the Five" and that in 1984, Kanter directed IRA to distribute the accumulated funds and its interest in the Essex Partnership n6 in a 45-45-10 ratio to TMT, Carlco and BWK, respectively. Additionally, the IRS contends that Ballard received unreported proceeds from the kickback scheme in the form of (1) continued distributions by IRA of Essex Partnership proceeds in the 45-45-10 ratio, (2) distribution in the 45-45-10 ratio of installment payments IRA received in connection with a stock repurchase of Property Management Systems, Inc. ("PMS") n7 held by IRA and (3) continued receipt of a portion of payments related to the San Francisco Hyatt Embarcadero Hotel n8.

B. Procedural History

Petitioners-Appellants received Notices of Deficiency from the IRS pertaining to years 1975 through 1982, 1984, and 1987 through 1989, alleging that they owed additional taxes. As to each deficiency asserted by the IRS, the Ballards filed petitions for redetermination in the Tax Court. Pursuant to I.R.C. § 7443A and Rules 180, 181 and 183, the Chief Judge of the Tax Court assigned the consolidated case to Special Trial Judge D. Irwin Couvillion for trial.

At the conclusion of the five-week trial during the summer of 1994, Special Trial Judge Couvillion, in accordance with Rule 183(b), prepared and submitted a written report containing his findings of facts and opinions to the Chief Judge for subsequent review by a Tax Court Judge. In accordance with Rule 183, none of the litigants received a copy of Special Trial Judge Couvillion's report at that time. Thereafter, pursuant to Rule 183(b), the Chief Judge assigned

the case to Tax Court Judge H.A. Dawson, Jr. for his review and final disposition. On December 15, 1999, Judge Dawson issued the opinion of the Tax Court in which the Tax Court both approved of and adopted Special Trial Judge Couvillion's report (T.C. Memo 1999-407; see Investment Research Assoc., Inc. v. Commissioner, 1999 Tax Ct. Memo LEXIS 459, 78 T.C.M. (CCH) 948, 1999 T.C. Memo 406 (1999)), a copy of which was provided to the parties. On July 24, 2001, Judge Dawson entered the final order of the Tax Court against Petitioners-Appellants, assessing tax deficiencies of $ 1,318,648. Of that amount, $ 422,812 is penalties against Ballard pursuant to I.R.C. § 6653(b).

On April 20, 2000, prior to the Tax Court's final order of assessment, the Ballards, joined by the other petitioners, filed a motion requesting access to "all reports, draft opinions or similar documents, prepared and delivered to the [Tax] Court pursuant to Rule 183(b)," or, in the alternative, that the Tax Court either certify the issue for interlocutory appeal pursuant to Rule 193 or make the initial findings part of the record for subsequent appeal to the circuit court. On April 26, 2000, Judge Dawson issued an order denying the motion. In the order, Judge Dawson noted that "[he] gave due regard to the fact that Special Trial Judge Couvillion evaluated the credibility of witnesses . . . and treated the findings of fact recommended by the Special Trial Judge as being presumptively correct." n9 On May 26, 2000, the Ballards, along with the other petitioners, filed a second motion with the Tax Court. The second motion requested that Special Trial Judge Couvillion's original report or other documentation be placed under seal and made part of the record for subsequent appellate review. That motion was denied on May 30, 2000.

On August 22, 2000, the Ballards, once again joined by the other petitioners, filed a motion requesting that the Tax Court reconsider its denial of access to Special Trial Judge

Couvillion's original report or, alternatively, that the Tax Court grant the petitioners a new trial. In support of this motion, an affidavit from Randall G. Dick ("Dick"), attorney for IRA and for Kanter, was filed. In the affidavit, Dick indicated that two unidentified Tax Court Judges approached him and stated that in the original report submitted to the Chief Judge in accordance with Rule 183(b), Special Trial Judge Couvillion concluded that payments made by "the Five" were not taxable to the individual petitioners and that the fraud penalty was not applicable. Furthermore, Dick indicated that the two unidentified Tax Court Judges expressed that "substantial sections of the opinion were not written by Judge Couvillion, and that those sections containing findings related to the credibility of witnesses and findings related to fraud were wholly contrary to the findings made by Judge Couvillion in his report." According to Dick, the two Tax Court Judges stated that the changes to Special Trial Judge Couvillion's findings relating to credibility and fraud were made by Judge Dawson. Finally, Dick indicated that he confirmed what he was told by the two unidentified Tax Court Judges with yet another unidentified Tax Court judge. Apparently, the third unidentified Tax Court Judge confirmed that Special Trial Judge Couvillion's opinion had been "changed." On August 30, 2000, the Tax Court issued an order signed by Special Trial Judge Couvillion, Judge Dawson and the Chief Judge of the Tax Court denying the motion and confirming that, contrary to the contents of the affidavit, the underlying report adopted by the Tax Court is, in fact, Special Trial Judge Couvillion's report.

Subsequently, the Ballards petitioned this court for a writ of mandamus seeking an order directing the Tax Court to provide the Ballards with a copy of the original Special Trial Judge Couvillion report or, alternatively, seeking an order requiring that the Tax Court provide any changes made by Judge Dawson to the original Special Trial Judge Couvillion

report. The petition was denied on October 23, 2000.

II. DISCUSSION

This court reviews decisions of the Tax Court "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." Pugh v. Commissioner, 213 F.3d 1324, 1325 (11th Cir. 2000) (quoting I.R.C. § 7482(a)(1)). Additionally, we review Tax Court conclusions of law de novo and findings of fact for clear error. Davis v. Commissioner, 210 F.3d 1346, 1347 (11th Cir. 2000).

A. Due Process

Petitioners-Appellants advance three grounds upon which the application of Rule 183 in this case violated their due process. First, Petitioners-Appellants assert that the Tax Court is the only trial court that mandates that the fact-finder submit the report of findings of fact and opinion to the court for adoption, modification or rejection before making the report available to the litigants. n10 Second, Petitioners-Appellants assert that the Tax Court's abrogation of the universally followed procedure of making known the fact-finder's report prior to any modification raises a presumption of a denial of due process. Petitioners-Appellants' final argument can be further divided into two subparts. First, they assert that although the findings of the Special Trial Judge are entitled to deference under Rule 183, as a result of not making the Special Trial Judge's report available, it is impossible to evaluate the actions of the reviewing Tax Judge thus violating Petitioners-Appellants' due process. Second, they assert that meaningful review of the Tax Court's actions by this court is not possible absent inclusion of the Special Trial Judge's original report in the record.

Although articulated separately, at the basic level,

Petitioners-Appellants' arguments make two points: (1) since the Special Trial Judge is the only official of the Tax Court to hear the presentation of evidence, the Tax Court should not be permitted to reach a conclusion contrary to the Special Trial Judge without re-hearing the evidence and/or an providing the parties an opportunity to be heard; and (2) because the Special Trial Judge's report is not included as part of the record, there can be no meaningful review of the Tax Court's actions per Rule 183(c). Because Petitioners-Appellants' arguments rely upon the same faulty premise, this court will address them jointly.

In short, Petitioners-Appellants' arguments are premised upon the assertion that the underlying report adopted by the Tax Court is not, in fact, Special Trial Judge Couvillion's report. Were that to be the case, we, too, would have significant concerns over the propriety of the process employed in this case. However, contrary to Petitioners-Appellants' assertions, the record as presented to us clearly reveals that the report adopted by the Tax Court is Special Trial Judge Couvillion's report. This critical fact is exhibited in the August 30, 2000 Order signed by Special Trial Judge Couvillion, Judge Dawson and the Chief Judge of the Tax Court. Consequently, Petitioners-Appellants' arguments are simply without merit. n11

Even assuming Dick's affidavit to be true and affording Petitioners-Appellants all reasonable inferences, the process utilized in this case does not give rise to due process concern. While the procedures used in the Tax Court may be unique to that court, there is nothing unusual about judges conferring with one another about cases assigned to them. These conferences are an essential part of the judicial process when, by statute, more than one judge is charged with the responsibility of deciding the case. And, as a result of such conferences, judges sometimes change their original position or thoughts. Whether Special Trial Judge Couvillion

prepared drafts of his report or subsequently changed his opinion entirely is without import insofar as our analysis of the alleged due process violation pertaining to the application of Rule 183 is concerned. Despite the invitation, this court will simply not interfere with another court's deliberative process.

The record reveals, and we accept as true, that the underlying report adopted by the Tax Court is Special Trial Judge Couvillion's. Petitioners-Appellants have not demonstrated that the Order of August 30, 2000 is inaccurate or suspect in any manner. Therefore, we conclude that the application of Rule 183 in this case did not violate Petitioners-Appellants' due process rights. Accordingly, we deny the request for relief and save for another day the more troubling question of what would have occurred had Special Trial Judge Couvillion not indicated that the report adopted by the Tax Court accurately reflected his findings and opinion.

B. Sufficiency of the Evidence

To sustain its fraud determination, the Tax Court found that the evidence clearly and convincingly demonstrated that Ballard received income resulting from transactions with "the Five" and attempted to evade the payment of taxes on that income through conduct designed to conceal, mislead, or otherwise prevent the collection of the appropriate taxes due. The Tax Court's fraud determination was based on: (1) Ballard's business acumen and understanding and appreciation of appropriate tax reporting; (2) Ballard's substantial and consistent failure to report approximately $ 3,200,000 in earned income related to "the Five" over a twelve year period; n12 (3) Ballard's failure to cooperate with the IRS during its audit; (4) Ballard's failure to maintain complete and accurate records pertaining to "the Five"; (5) Ballard's use of a large number of Kanter entities designed

for no purpose other than to confuse and disguise income from "the Five"; and (6) Ballard's false and misleading testimony to the Tax Court.

In response, Petitioners-Appellants argue that the evidence is insufficient to support the Tax Court's finding that Ballard received and fraudulently failed to report income. Petitioners-Appellants advance a number of reasons why we should overrule the Tax Court, however, the question before us is not whether there are strong arguments against the findings of the Tax Court. Rather, the question before us is whether the Tax Court's findings are "clearly erroneous." See Comm'r v. Duberstein, 363 U.S. 278, 291, 80 S. Ct. 1190, 1200, 4 L. Ed. 2d 1218, 1228 (1960); Korecky v. Comm'r, 781 F.2d 1566, 1568 (11th Cir. 1986) (citing Marsellus v. Commissioner, 544 F.2d 883, 885 (5th Cir. 1977); Webb v. Commissioner, 394 F.2d 366, 378 (5th Cir. 1968)). n13 "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." University of Georgia Athletic Assoc. v. Laite, 756 F.2d 1535, 1543 (11th Cir. 1985) (quoting United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746 (1948)).

n11 By innuendo, counsel seem to imply that some improper motive caused these alleged changes in Special Trial Judge Couvillion's original report as compared to the final opinion of the Tax Court. (Appellants' Br. at 5). If Petitioners-Appellants believe that a Tax Court Judge has engaged in neglect of duty or malfeasance in office, this court refers Petitioners-Appellants to I.R.C. § 7443(f) as the appropriate manner by which to address such a circumstance.

Based upon our careful review of the record and consideration of oral argument, we are not left with "a definite and firm conviction that a mistake has been committed." When the conduct of the parties and flow of

money is examined in this case, there is strong support for the Tax Court's conclusion that Ballard earned and received income related to "the Five." The record supports the Tax Court's conclusion that Ballard, Lisle and Kanter entered into an agreement to split proceeds from "the Five" in a 45-45-10 ratio and that Ballard ultimately received his share of those proceeds via direct distributions to TMT, through sham loans by Kanter to Ballard, or through sham consultant payments to Ballard's family members. Furthermore, the Tax Court's fraud determination is strongly supported by the record. While no single indicia of fraud present in this case is determinative, the number and combination of those indicia leave us with an abiding belief that the Tax Court did not clearly err in its fraud determination.

Illustrative of our conclusion is the first of "the Five" transactions involving Weaver and the Embarcadero Hotel in San Francisco, California. Ballard first met Weaver in the late 1960s as a product of joint involvement in the development of the Houston Hyatt Hotel. Thereafter, in the early 1970s, Prudential became involved in a joint venture to build the San Francisco Embarcadero Hotel. The joint venture sought an experienced hotel management company to operate the Embarcadero Hotel and, as it so happened, Lisle was participating in the selection of the hotel management company.

A.N. Pritzker ("Pritzker"), one of Kanter's clients and then Hyatt Corp. ("Hyatt") president, was interested in securing the property management contract on the San Francisco Embarcadero Hotel. Lisle, however, was initially not interested in having Hyatt manage the San Francisco Embarcadero Hotel and was not going to allow Hyatt to bid on the contract. Pritzker was determined to win the management contract for Hyatt and offered to pay Weaver if he, through his connection with Ballard and Lisle, could secure the management contract for Hyatt. Through

Weaver's efforts, Hyatt was authorized to bid on the management contract. Ballard was tasked with evaluating the various proposals submitted and, as it turns out, Hyatt was ultimately awarded the property management contract during a meeting attended by both Ballard and Lisle.

In acknowledgement of Weaver's assistance in securing for Hyatt the San Francisco Embarcadero Hotel management contract, Hyatt entered into an agreement with KWJ (Weaver's corporation) to pay Weaver 10% of its fees on the management contract. The hotel opened in May of 1973. Thereafter, the record reflects Weaver received payments equal to 10% of the fees Hyatt received on the management contract. n14

In 1976, IRA (Kanter's corporation) entered into an agreement to purchase 100% of KWJ's stock. Although the Hyatt agreement was worth millions to Weaver, Weaver agreed to sell his rights in KWJ to IRA for $ 150,000 plus 30% of future Hyatt Payments. n15 During the time Kanter and Weaver were solidifying their deal, Hyatt was in the process of becoming privately owned. Kanter did not want the transfer of the KWJ stock to take place until after Hyatt became privately owned, therefore, Kanter's deal with Weaver was framed as a four-year option to buy Weaver's KWJ stock which allowed for IRA to non-publicly purchase the KWJ shares.

In 1979, following Hyatt becoming privately owned, IRA exercised its option to purchase the KWJ shares. n16 At that time, IRA obtained a net 70% ownership interest in the future Hyatt payments as well as KWJ's net worth of $ 115,084. Hyatt was not informed of the Weaver-Kanter deal and continued to send the annual [*25] payments to Weaver. n17 Upon receipt of payments from Hyatt, Weaver would forward the check to IRA which, either through KWJ

or the KWJ Co. partnership, would then "kickback" Weaver's 30% and deduct the payment as a commission expense. On one occasion, relied heavily upon by the Tax Court in support of its finding of an agreement to split the Hyatt payments between Ballard, Lisle and Kanter, Weaver forwarded the annual Hyatt payment with a letter requesting that Kanter deposit the check and "issue appropriate checks to the participants." n18

The record supports that a portion of the proceeds from the Hyatt contract, as with other proceeds related to "the Five," were ultimately distributed to Ballard through a number of means including direct distributions to TMT, through sham loans by Kanter and various Kanter entities to Ballard, or through sham consultant payments to Ballard's family members. Thus, we agree with the Tax Court that if one follows the circuitous and sometimes obfuscated flow of money for each of "the Five," inevitably, Ballard receives 45% of the proceeds his efforts helped to procure and for which he failed to properly report and pay taxes.

III. CONCLUSION

The decision of the Tax Court is affirmed.

AFFIRMED.

- - - - - - - - - - - - Footnotes - - - - - - - - - - - - - - -

* Honorable John R. Gibson, United States Circuit Judge for the Eighth Circuit, sitting by designation.

n1 Mary B. Ballard is a participant in this dispute solely as a result of having filed joint tax returns with her spouse Claude M. Ballard; therefore, unless otherwise specified, all references will be to Claude M. Ballard.

n2 Referred to as "the Five," the IRS contends that the Ballard, Lisle, Kanter influence scheme resulted in the receipt of payments from the following five individuals: J.D. Weaver, Bruce Frey, William Schaffel, Kenneth Schnitzer and John Eulich.

n3 The IRS alleges that a similar method was employed to funnel proceeds of the scheme to Lisle; however, that case is not before us.

n4 Formed in 1979, IRA was originally incorporated as Cedilla Co. in 1974. For purposes of clarity, however, IRA will be used throughout.

n5 According to the IRS, TMT was a subsidiary of IRA that was controlled by Ballard and was the instrument utilized to provide Ballard with his share of the kickback proceeds. Carlco and BWK were subsidiaries controlled by Lisle and Kanter, respectively.

n6 According to the IRS, the Essex Partnership was formed by Kanter, John Eulich and others as part of the fifth kickback arrangement of "the Five." As alleged, IRA maintained a 26.125% interest in the partnership.

n7 According to the IRS, the PMS stock repurchase pertains to the fourth kickback arrangement of "the Five."

n8 According to the IRS, the first kickback arrangement involved an agreement between the Hyatt Corp. ("Hyatt") and the KWJ Corp. ("KWJ"), a company controlled by J.D. Weaver ("Weaver"), whereby Hyatt, based on Weaver's relationship with

Ballard and Lisle, would pay Weaver part of its annual management fee for his assistance in securing Hyatt the management contract for Prudential's San Francisco Embarcadero Hotel. Thereafter, IRA obtained a 70% interest in Weaver's Hyatt payments. Consistent with the other arrangements, TMT received 45% of the payments IRA received from Weaver.

n9 Rule 183(c) provides in relevant part, "due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct."

n10 Petitioners-Appellants contrast the procedures employed by the Tax Court pursuant to Rule 183 with the procedures utilized by Magistrate Judges, Administrative Law Judges and Special Masters. However, for the reasons stated, we find the comparisons to be unavailing.

n11 By innuendo, counsel seem to imply that some improper motive caused these alleged changes in Special Trial Judge Couvillion's original report as compared to the final opinion of the Tax Court. (Appellants' Br. at 5). If Petitioners-Appellants believe that a Tax Court Judge has engaged in neglect of duty or malfeasance in office, this court refers Petitioners-Appellants to I.R.C. § 7443(f) as the appropriate manner by which to address such a circumstance.

n12 The Tax Court determined that approximately $ 1,000,000 of additional income was earned by Ballard

related to "the Five." However, the IRS did not issue notices of deficiencies for the relevant years in which the income was earned, therefore, the Tax Court did not have jurisdiction to determine whether or not the tax related to that income had been underpaid. See I.R.C. § 6214(b).

n13 In Bonner v. City of Prichard, 661 F.2d 1206 (11th Cir. 1981) (en banc), this court adopted as precedent all decisions of the former Fifth Circuit Court of Appeals decided prior to October 1, 1981.

n14 Although not all operating years are within the Tax Court's jurisdiction, the record supports that Hyatt made the following payments to KWJ:

Operating Year	Payment Year	Payment
1973	1974	--
1974	1975	--
1975	1976	--
1976	1977	$ 54,848
1977	1978	$ 60,739
1978	1979	--
1979	1980	$ 171,027
1980	1981	$ 128,671
1981	1982	$ 24 ,717
1982	1983	$ 245,843

In 1983, unbeknownst to Hyatt, KWJ Corp. liquidated and distributed its assets to IRA. In 1984, IRA's subsidiaries TMT, Carlco, and BWK formed the dubiously named KWJ Co. partnership in which TMT (i.e., Ballard) and Carlco (i.e., Lisle) each had a 45% interest and BWK (i.e., Kanter) a 10%

interest. Thereafter, the KWJ Co. partnership received the following payments:

1983 1984 --
1984 1985 $ 295,415
1985 1986 $ 330,376
1986 1987 $ 327,784
1987 1988 $ 281,926
1988 1989 $ 75,396
1989 1990 $ 24,340

n15 In effect, Weaver was giving up 70% of his Hyatt payments for $ 150,000.

n16 The Kanter-Weaver deal provided for an initial payment of $ 10,000 by IRA for the KWJ stock. The remaining $ 140,000 purchase price was to be paid by August of 1980. Since Hyatt paid KWJ $ 171,027 for the 1979 operating year, IRA simply utilized what otherwise would have gone to Weaver to pay off the remaining balance owed. Thus, IRA assumed ownership of KWJ and the multi-million dollar contract with Hyatt for little to no out-of-pocket money.

n17 As stated above, in 1983, unbeknownst to Hyatt, KWJ Corp. liquidated and its assets were distributed to IRA. Thereafter, IRA subsidiaries TMT (i.e., Ballard), Carlco (i.e., Lisle) and BWK (i.e., Kanter) formed the KWJ Co. partnership and continued to receive the Hyatt payments.

n18 The Tax Court concluded and we concur that "the participants" is reference to Ballard and Lisle.

United States Tax Court.
INVESTMENT RESEARCH ASSOCIATES, LTD., and Subsidiaries, et al., [FN1]
Petitioners
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent
No. 25875-90, 23178-91, 26918-92, 20211-91, 1984-92, 22884-93, 21555-91, 19314-92, 25981-93, 43966-85, 3456-88, 26251-90, 45273-86, 32103-88, 20219-91, 31301-87, 16421-90, 24002-91, 21616-91, 16164-92, 25976-93, 33557-87, 23743-92, 712-86, 30830-88, 7557-93, 1350-87, 27444-89.
Dec. 15, 1999.
Randall G. Dick and Jeffrey I. Margolis, for petitioners in docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 25875-90, 26251-90, 23178-91, 24002-91, 19314-92, 26918-92, 25976-93, and 25981-93.
Royal B. Martin and Steven S. Brown, for petitioners in docket Nos. 16421-90, 20211-91, 20219-91, 21555-91, 21616-91, 1984-92, 16164-92, 23743-92, 7557-93, and 22884-93.
Mark E. O'Leary, John J. Comeau, James M. Cascino, Jonathan P. Decatorsmith, James M. Klein, G. Roger Markley, and Pamela V. Gibson, for respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

DAWSON, J.
These consolidated cases were assigned to Special Trial Judge D. Irvin Couvillion pursuant to Rules 180, 181, and 183. [FN2] The Court agrees with and adopts the opinion of the Special Trial Judge, which is set forth below.
OPINION OF THE SPECIAL TRIAL JUDGE

COUVILLION, Special Trial J.
In these consolidated cases, respondent determined deficiencies in petitioners' Federal income taxes, additions to tax, [FN3] penalties, and increased interest, as follows:
Investment Research Associates, Ltd., and Subsidiaries
Docket No. 43966-85:

Year	Deficiency	Addition to Tax Sec. 6659(a)
1979	$18,791	$5,637

Docket No. 45273-86:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6659(a) Sec. 6661
---- --------- -------- ---------- --------
1982 $174,225 $8,711 $49,154 $1,038

Docket No. 30830-88: 1
Additions to Tax

Year Deficiency Sec. 6653 Sec. 6659(a) Sec. 6661
---------- ---------- ---------- ---------- ----------
1983 $595,838 $29,792 $16,767 $134,987
1984 410,317 20,516 – 102,579
FN1. In docket No. 30830-88 the deficiencies in tax determined in the notice of
deficiency are $595,838 and $410,317, respectively, for 1983 and 1984. Page 2
of respondent's opening brief states the deficiencies to be $181,546 and
$123,095, respectively, for 1983 and 1984. The Court assumes that the amounts
stated in respondent's opening brief are in error.

Docket No. 27444-89:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6661
--- -------- ------- -------
1985 $400,488 $20,024 $100,122

Docket No. 25875-90:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6661
--- -------- -------- --------
1986 $2,110,643 $105,532.15 $527,660.75

Docket No. 23178-91:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6661
---- --------- -------- ---------
1987 $5,739,249 $286,962 $1,434,812

Docket No. 19314-92:

Additions to Tax

Year Deficiency Sec. 6651(a)(1) Sec. 6653
---- -------- ---------- --------
1980 $1,304,063 $195,609.45 $65,203.15

Docket No. 25976-93:

Additions to Tax Penalty

Year Deficiency Sec. 6653 Sec. 6661 Sec. 6662(a)
--- -------- ------- ------- --------
1988 $768,025 $38,401 $192,006 –
1989 878,898 – – $175,780

Burton W. and Naomi R. Kanter

Additions to Tax Penalty
--- ------
Docket No. Year Deficiency Sec. 6653 Sec. 6659 Sec. 6661 Sec. 6662
-------- --- --------- -------- ------- -------- -------
712-86 1981 $340,578.00 $17,029.00 $42,682 – –
1350-87 1982 2,086,913.00 104,346.00 – $208,691.00 –
31301-87 1978 476,999.00 – – – – –
3557-87 1980 454,396.00 22,720.00 – – –

3456-88 1979 183,809.37 9,190.47 -- -- --
32103-88 1984 3,825,078.00 191,254.00 -- 949,211.00 --
26251-90 1983 1,150,652.00 57,532.60 -- 287,663.00 --
1986 897,224.00 44,861.00 -- 223,666.00 --
24002-91 1987 1,434,529.00 71,726.45 -- 358,632.25 --
26918-92 1988 523,234.00 26,162.00 -- 130,809.00 --
25981-93 1989 835,847.00 -- -- -- $167,169

Claude M. and Mary B. Ballard
Docket No. 16421-90:

Additions to Tax

Year	Deficiency	Sec. 6653	Sec. 6661
1982	$55,338	$2,766.90	$8,774

Docket No. 20211-91:

Additions to Tax

Year	Deficiency	Sec. 6651(a)(1)	Sec. 6653	Sec. 6661
1984	$981,072	1 $51,3311	$88,788.05	$245,268

FN1. On brief, respondent concedes this addition to tax.

Docket No. 21616-91:

Additions to Tax

Year	Deficiency	Sec. 6653	Sec. 6661
1987	$208,449	$10,422.45	$52,112.25

Docket No. 1984-92:

Additions to Tax

Year	Deficiency	Sec. 6653	Sec. 6659
1975	$23,453	$1,173	--
1976	34,024	1,701	--
1977	11,502	--	--
1978	3,923	--	--
1979	21,630	--	--
1980	92,481	--	--
1981	193,743	9,687	$17,138

Docket No. 23743-92:

Addition to Tax

Year	Deficiency	Sec. 6653
1988	$125,136	$6,257

Docket No. 22884-93:

Penalty

Year	Deficiency	Sec. 6662
1989	$179,924	$35,985

Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors

Additions to Tax Penalty

Docket No.	Year	Deficiency	Sec. 6653	Sec. 6661	Sec. 6662(a)
20219-91	1984	$827,955	$41,397.75	$206,988.75	--

21555-91 1987 195,498 9,774.90 48,874.50 --
16164-92 1988 109,048 5,452.00 27,262.00 --
7557-93 1989 109,049 -- -- $21,810

In the following cases, respondent determined in the notices of deficiency or asserted in amended answers that the underpayments in tax were subject to increased interest under section 6621(c), formerly section 6621(d): [FN4]
Investment Research Associates, Ltd., and Subsidiaries:

Docket No. Year
--------- ---
43966-85 1979
45273-86 1982

Burton W. and Naomi R. Kanter:

Docket No. Year
---------- ----------
1350-87 1982
33557-87 1980
3456-88 1 1979
32103-88 1984
26251-90 1983, 1986
24002-91 1987
FN1. On brief, respondent concedes that the underpayment attributable to the
disallowed loss from Immunological Research Corp. is not subject to increased
interest under sec. 6621(c), following Estate of Cook v. Commissioner, T.C.
Memo.1993-581.

Claude M. and Mary B. Ballard:

Docket No. Year
------- ----------

16421-90 1982
20211-91 1984
21616-91 1987
1984-92 1975, 1976, 1977, 1978
1979, 1980, 1981
23743-92 1988

Estate of Robert W. Lisle, Deceased, etc.:

Docket No. Year
--------- ---
20219-91 1984
21555-91 1987
16164-92 1988

In amended answers, respondent alleged increases in the deficiencies in tax and additions to tax in the following cases:

Petitioner Docket No. Year(s)
---------- -------- ----------
Investment Research Associates, 45273-86 1982
Ltd., and Subsidiaries 43966-85 1979
Burton W. and Naomi R. Kanter 712-86 1981
1350-87 1982
31301-87 1978
33557-87 1980
3456-88 1979
32103-88 1984
26251-90 1983, 1986
24002-91 1987
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Claude M. and Mary B. Ballard 16421-90 1982
20211-91 1984
21616-91 1987
1984-92 1975, 1976, 1977

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23743-92 1988
22884-93 1989

Estate of Robert W. Lisle, 20219-91 1984
Deceased, etc. 21555-91 1987
16164-92 1988
7557-93 1989

In the amended answers, respondent alleged that the underpayments in tax with respect to all or, alternatively, with respect to substantial portions of the increased deficiencies in tax were subject to the addition to tax for fraud pursuant to section 6653(b) or the penalty for fraud pursuant to section 6663(a) in the following cases: [FN5]

Petitioner	Docket No.	Year(s)
Investment Research Associates, Ltd. and Subsidiaries	23178-91	1987
Burton W. and Naomi R. Kanter	712-86	1981
	31301-87	1978
	33557-87	1980
	3456-88	1979
	32103-88	1984
	26251-90	1983, 1986
	24002-91	1987
	26918-92	1988
	25981-93	1989
Claude M. and Mary B. Ballard	16421-90	1982
	20211-91	1984
	21616-91	1987
	1984-92	1975, 1976, 1977
		1978, 1979, 1980
		1981

	23743-92	1988
	22884-93	1989
Estate of Robert W. Lisle, Deceased, etc.	20219-91	1984
	21555-91	1987
	16164-92	1988
	7557-93	1989

Introduction

In each of the cases in which fraud is alleged, respondent alleged that, if the Court holds that the underpayments in tax are not subject to fraud additions, alternatively, the underpayments in tax are subject to additions to tax under sections 6653(a)(1) and (2) and 6659(a), and the increased interest under section 6621(c), or if the underpayment is for 1989, that it is subject to a penalty under section 6662.

In all of the amended answers in which respondent asserted increased deficiencies in tax, as well as increased additions to tax and penalties, respondent did not calculate or assert the amounts of the increased tax deficiencies or the amounts of the additions to tax or penalties. Respondent asserted only the amounts of increased income or the amounts of disallowed expenses that would result in increased deficiencies in tax and additions to tax. As a result of these amended answers, and as a result of numerous concessions and stipulations of settlement that were made by the parties before, during, and after the trial, as well as concessions of certain issues by respondent on brief, Rule 155 computations will be necessary in some of the cases. [FN6]

These cases are part of a larger group of cases that have also been identified by respondent as a litigation project. The sobriquet for this project is "Levenfeld/Kanter". These cases were selected for trial because, as the Court understands, they involve common issues that the other cases in this project do not have.

References to Kanter, Ballard, and Lisle are to Burton W. Kanter, Claude M. Ballard, and Robert W. Lisle, respectively.

Reference to the Kanters, Ballards, and Lisles are to Burton W. and Naomi R. Kanter, Claude M. and Mary B. Ballard, and Robert W. and Donna M. Lisle, respectively.

The issues to be decided are:

(1) Whether payments made by the Five in the Prudential, Travelers, and Kanter transactions during the years at issue are properly taxable to Kanter, Ballard, and Lisle, and, if so, whether they are liable for the fraud additions to tax and penalty with respect to such income;

(2) whether certain commitment fees paid to Century Industries, Ltd., are includable in Kanter's income for 1981, 1982, 1983, 1984, and 1986;

(3) whether Kanter received unreported income from Hi-Chicago Trust for 1981, 1982, and 1983;

(4) whether Kanter is taxable on the income of the Bea Ritch Trusts for 1986, and 1987;

(5) whether Kanter had unreported income for 1982, 1983, 1984, 1987, 1988, and 1989 from the CMS Investors Partnership;

(6) whether Kanter had unreported income in 1983 from Equitable Leasing Co., Inc.;

(7) whether Kanter had unreported income in 1982 based on the bank deposit analysis method;

(8) whether Kanter received barter income from Principal Services in 1988 and 1989;

(9) whether the Kanters are entitled to certain deductions claimed on Schedule A and Schedule C for 1986 through 1989;

(10) whether Kanter, in 1983, realized capital gains under section 357(b) and (c) from the assumption by Cashmere Investment Associates, Inc., of partnership interests having negative capital accounts and whether, under section 453, the installment method was available for the reporting of such gains;

(11) whether Kanter is entitled to research and development and business expense deductions from Immunological Research Corporation for 1979;

(12) whether Kanter had unreported partnership income for 1978;

(13) whether the Kanters are entitled to a loss from GLS Associates for 1981;

(14) whether the Kanters are entitled to a loss from computer leasing transactions involving Equitec for 1983 and 1984;

(15) whether the Kanters are entitled to investment interest expense deductions for 1981;

(16) whether the Kanters are entitled to an investment tax credit carryover for 1978;

(17) whether the Kanters are entitled to an interest deduction for 1986;

(18) whether the Kanters received unreported interest income from a bank in 1988;

(19) whether Kanter is entitled to a business loss deduction in 1980 in connection with the sale of a painting;

(20) whether the Kanters are entitled to deduct a claimed charitable contribution of $15,000 to the Jewish United Fund in 1982;

(21) whether the Kanters are entitled to claimed capital gains and losses in 1987;

(22) whether respondent correctly made adjustments to the rental income, depreciation, interest expense, and investment tax credits claimed by Investment Research Associates, Ltd. (IRA) in connection with equipment leasing transactions for 1979, 1980, and 1982 through 1989;

(23) whether IRA is entitled to a claimed loss on Form 4797 of $1,073,835 for 1988;

(24) whether IRA is entitled to a charitable contribution carryover deduction for 1983;

(25) whether IRA is entitled to certain claimed capital losses for 1985;

(26) whether IRA is entitled to claimed bad debt deductions for 1987;

(27) whether IRA is entitled to claimed ordinary losses on sales of notes receivable for 1987;

(28) whether IRA is entitled to certain capital losses for 1987;

(29) whether IRA is entitled to deduct as business expenses amounts paid to J.D. Weaver in 1979, 1981, and 1982;
(30) whether the assessment and collection of the deficiency and additions to tax as to IRA for 1980 are barred by the statute of limitations;
(31) whether IRA is liable for the fraud addition to tax for 1987;
(32) whether assessment and collection of Federal income taxes of Kanter, Ballard, and Lisle are barred by the statute of limitations for some years;
(33) the liabilities of Kanter, Ballard, and Lisle for additions to tax for negligence;
(34) whether the Kanters are liable for the section 6659 addition to tax for 1981;
(35) whether Kanter is liable for section 6661 additions to tax for 1982 through 1984, and 1986 through 1988;
(36) whether Kanter is liable for section 6621(c) increased interest for 1978, 1979, 1980 through 1984, and 1986, and 1987, and 1988;
(37) whether IRA is liable for the section 6651(a)(1) addition to tax for 1980;
(38) whether IRA is liable for the section 6653(a) additions to tax for 1980, and 1982 through 1988;
(39) whether IRA is liable for the section 6659(a) additions to tax for 1982 and 1983;
(40) whether IRA is liable for the section 6661 additions to tax for 1983 through 1988; and
(41) whether IRA is liable for the section 6662(a) accuracy-related penalty for 1989.

For convenience and clarity, the Court's findings of fact and opinion are set forth under each issue. The findings of fact with respect to any issue incorporate by this reference the findings of fact as found in any preceding issue.

Issue 1. Whether Payments Made By the Five in the Prudential, Travelers, and Kanter Transactions During the Years at Issue Are Properly Taxable to Kanter, Ballard, and Lisle, and, if so, whether they are liable for the fraud additions to tax and penalty with

respect to such income

FINDINGS OF FACT

The parties have filed several stipulations of fact. The facts reflected in these stipulations, with the annexed exhibits, are so found and are incorporated herein by reference.

I. Background

A. Petitioners' Residences and Principal Place of Business

At the time the petitions were filed, the principal place of business of Investment Research Associates, Ltd. (IRA), was in the State of Illinois, the Kanters' legal residence was in the State of Illinois, the Ballards' legal residence was in the State of Florida, and the Lisles' legal residence was in the State of Texas. Donna Lisle died on April 12, 1993, and Robert W. Lisle died on September 17, 1993. Their two children, Amy L. Albrecht and Thomas W. Lisle, are the coexecutors of the Estates of Robert W. Lisle and Donna M. Lisle. The estates have been substituted as parties and the two children as representatives of the estates. Amy Albrecht and Thomas Lisle were legal residents of the State of Texas at the time they were substituted as representatives of the estates of their deceased parents.

B. Kanter

Kanter is an attorney who has been engaged continuously in the practice of law in Chicago, Illinois, since about 1956. He received a J.D. degree from the University of Chicago in 1952. From 1952 to 1954, he was a teaching associate at the University of Indiana Law School. Since 1956, his law practice has been in Chicago, Illinois. His primary expertise is in Federal income and estate taxation. From 1964 to 1981, Kanter was a partner in the law firm of Levenfeld & Kanter, which later became Levenfeld, Kanter, Baskes & Lippitz. That firm was dissolved in 1981, and Kanter thereafter practiced with the firm of Kanter & Eisenberg. As of the time of trial, Kanter was of counsel with the Chicago firm of Neal, Gerber & Eisenberg.

At the time of the trial and for the prior 10 years, Kanter taught courses in estate and gift taxation and estate planning

at the University of Chicago Law School. Kanter has lectured and written extensively in the area of Federal tax law. He has also been an active participant in professional bar associations. For a number of years, Kanter has been a writer and contributor to the Journal of Taxation, a national monthly publication devoted exclusively to Federal taxation. One of the features of this publication is the Shop Talk section which he originated. At the time of trial, Kanter was a senior editor with the Journal of Taxation. Kanter is generally recognized as well known in his field. This recognition has resulted in a successful law practice, which has led to Kanter's being involved in consultation, development, and investments in a number of business fields and enterprises. For instance, Kanter has performed extensive legal work for the Pritzker family, majority owners of the Hyatt Corp., a major hotel company. Kanter also served as a director on the boards of several corporations and charitable organizations.

Petitioner Naomi R. Kanter, Kanter's wife, was not involved in any of the activities giving rise to this litigation. However, she filed joint Federal income tax returns with Kanter for the years at issue.

C. Ballard

Ballard was an employee in the real estate department of The Prudential Insurance Co. of America (Prudential) from 1948 until his retirement in 1982. During the course of his career at Prudential, Ballard was assigned to several regional offices of Prudential, including Houston and Dallas, Texas, and beginning in 1966 in the corporate headquarters of Prudential at Newark, New Jersey, and then again, for a short time, at the Houston regional office. In 1973, he was reassigned to Prudential's Newark corporate headquarters, where he remained until his retirement in early 1982. At the time he left Prudential, Ballard was a senior vice president in charge of equities and worked under Donald Knab (Knab), who was in charge of all of Prudential's real estate operations.

Ballard's work with Prudential in its real estate equity operations involved the purchase, development, management, and sale of property. Ballard supervised the staff of this department at Prudential's headquarters, as well as the real estate department staff at Prudential's regional and field offices throughout the United States. Ballard could influence the choice of builders and contractors for Prudential projects and could influence or prevent a project from going forward.

Shortly after leaving Prudential, Ballard became a general partner with Goldman Sachs, an investment firm in New York City. In November of 1988, he retired as a general partner and became a limited partner with Goldman Sachs. In his position with Prudential, Ballard met and was in contact with attorneys, developers, businessmen, and contractors involved in or affected by Prudential's real estate activities.

D. Lisle

Lisle graduated from the University of Missouri with a B.S. degree in public administration. He attended law school at the University of Missouri, graduate schools of management and business at Columbia University, and the graduate school of management at Princeton University.

Like Ballard, Lisle was employed by Prudential. Lisle worked for Prudential in real estate development and in mortgage financing from September 1950 to April 1982. Lisle headed the division responsible for lending money and buying and building real estate for Prudential. He had authority to commit any loan up to $20 million and to award construction contracts. The development aspect of his work was conducted through a subsidiary corporation of Prudential known as PIC Realty Corp. (PIC Realty). [FN7] Lisle was president of PIC Realty.

To a large extent, Lisle's career paralleled Ballard's. Like Ballard, Lisle worked in various regional offices of Prudential and ultimately was promoted to a senior executive position at Prudential's Newark corporate

headquarters. The offices of Lisle and Ballard were next door to each other, and Lisle's supervisor at Prudential was also Donald Knab. To some extent, Ballard and Lisle's duties overlapped. At the time Lisle left Prudential in 1982, he was a vice president of Prudential.

In April 1982, after leaving Prudential, Lisle began working for The Travelers Insurance Co. (Travelers), doing virtually the same kind of work he had done for Prudential. He worked for Travelers until April 1988.

Donna M. Lisle, Lisle's wife, was not involved in any of the activities giving rise to this litigation, and her estate is a party to these proceedings solely by virtue of Mrs. Lisle's having filed joint Federal income tax returns with Lisle for the years at issue.

II. The Kanter Enterprise

A. Overview

Kanter met Ballard and Lisle sometime between 1968 and 1970. The three had numerous contacts and business dealings in succeeding years.

Kanter entered into arrangements pursuant to which he would use his business and professional contacts, including his relationships with the Pritzkers, Ballard, and Lisle, to assist individuals and/or entities in obtaining business opportunities or in raising capital for business ventures. Kanter established a complex organization of corporations, partnerships, and trusts to receive, distribute, and disguise the payments from these arrangements.

Some of these arrangements involved payments from a group of individuals referred to by the parties as "the Five". The Five made payments for Ballard's and Lisle's influence in awarding contracts with Prudential (the Prudential transactions), for Lisle's influence in awarding contracts with Travelers (the Travelers transactions), and for Kanter's influence in transactions that did not involve Prudential or Travelers (the Kanter transactions). The payments most often were made to corporations controlled by Kanter and then distributed through various means to Kanter, Ballard,

and/or Lisle, their family members, or to entities established for the benefit of their families.

Most of the payments made in the Prudential transactions were paid through IRA or one of its subsidiaries. Those made in the Travelers and Kanter transactions generally were made through another corporation controlled by Kanter, The Holding Co. (Holding Co.) or one of its subsidiaries. Funds received by IRA and its subsidiaries and Holding Co. and its subsidiaries, as well as funds of other Kanter entities and associates, were commingled in accounts administered by another Kanter controlled entity, The Administration Co. (Administration Co.) (and later Principal Services Corp.).

Some distributions to Kanter, Ballard, and Lisle were characterized as commissions, consulting fees, or directors fees. Others were recorded as receivables or loans, many of which were traded or transferred between the various entities and eventually written off as uncollectible with IRA and/or Kanter taking deductions for the writeoffs. Some of the distributions that were treated as loans were made through two Kanter entities, International Films, Inc. (Int'l Films) and Harbor Exchange Lending Operation (HELO). Large portions of the payments made in the Prudential transactions eventually were distributed to three of IRA's subsidiaries; more specifically, 45 percent to Carlco, Inc. (Carlco) (controlled by Lisle), 45 percent to TMT, Inc. (TMT), (controlled by Ballard), and 10 percent to BWK, Inc. (controlled by Kanter).

An overview of the Kanter enterprise is shown by the following diagram:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

B. Investment Research Associates, Inc., and Its Subsidiaries

IRA was originally incorporated in the State of Delaware on August 26, 1974, under the name of Cedilla Co. In 1979, the name of Cedilla Co. was changed to Investment Research Associates, Ltd. Reference hereinafter to IRA also refers to its

predecessor, Cedilla Co. during years prior to the name change.

1. IRA Stock

At the time of its incorporation in 1974, IRA was authorized to issue 1,000 shares of 10-cent par value common stock, 8,000 shares of $1 par value class A preferred stock, and 1,000 shares of 10-cent class B preferred stock. By 1977 IRA was also authorized to issue 1,000 shares of $5,000 par value class C preferred stock.

IRA's annual franchise reports filed with the State of Delaware from 1975 to 1988 reported that the following shares of stock were issued and outstanding:

Year	Common	Preferred	
	Class A	Class B	Class C
1975	[blank]	[blank]	[not authorized]
1976	[blank]	[blank]	[not authorized]
1977	1,000	1,000	500 [not authorized]
1978	1,000	1,000	none none
1979	none	1,000	1,000 none
1980	1,000	1,000	none none
1981	[blank]	[blank]	[blank] [blank]
1982	none	none	none none
1983	1,000	1,000	[blank] [blank]
1984	[blank]	[blank]	[blank] [blank]
1985	[blank]	[blank]	[blank] [blank]
1986	1,000	-0-	-0- -0-
1987	[blank]	[blank]	[blank] [blank]
1988	[blank]	[blank]	[blank] [blank]

IRA's end-of-year balance sheets from 1975 to 1989 indicate the following stockholder equity attributable to the preferred and common stock:

Year	Preferred	Common
1975	$1,050	$100
1976	1,050	100
1977	1,000	100
1978	1,000	100
1979	1,000	100
1980	1,000	100
1981	1,000	100
1982	1,000	100
1983	-0-	100
1984	-0-	100
1985	-0-	100
1986	-0-	100
1987	-0-	100
1988	-0-	100
1989	-0-	100

2. IRA Stockholders

IRA's 1976 return reported that no individual, partnership, corporation, estate, or trust at the end of the year owned (or was attributed ownership under section 267(c)) 50 percent or more of the corporation's total voting stock. IRA's returns reported that from 1977 through 1982, Solomon Weisgal, trustee of the Bea Ritch Trusts, owned 50 percent of IRA's voting stock, and Mildred Schott owned the remaining 50 percent of IRA's voting stock. The Bea Ritch Trusts owned 1,000 shares of common stock, and Schott owned 1,000 shares of class A preferred voting stock. IRA's returns for 1984 through 1989 indicated that no individual, partnership, corporation, estate, or trust at the end of the year owned (or was attributed ownership under section 267(c)) 50 percent or more of the corporation's total voting stock.

a. Mildred Schott and Delores Keating

Mildred Schott (Schott) worked as a legal secretary and had a real estate broker's license. She was introduced to Kanter by a mutual acquaintance. Before she obtained her broker's

license, she worked as a real estate sales person for Delores Keating (Keating).

Prior to October 28, 1975, Keating owned 1,000 shares of common stock of Cedilla Co. On October 28, 1975, Keating's 1,000 shares of common stock were exchanged for 500 shares of the class B preferred stock, and 1,000 shares of common stock were issued to the Bea Ritch Trusts. By 1978, Keating's 500 shares of class B preferred stock were redeemed by the corporation.

Schott held 1,000 shares of the class A preferred stock until 1982. She held the stock to enable IRA to hold a corporate real estate license.

b. The Bea Ritch Trusts

Twenty-five trusts known collectively as the Bea Ritch Trusts were established in 1969 and were named after Beatrice K. Ritch, Kanter's mother. Kanter's mother is the named grantor, ostensibly contributing $100 to each of the 25 trusts. Originally, when the 25 Bea Ritch Trusts were established in 1969, the beneficiaries of the trusts were Kanter, his family, and other relatives of Kanter. By about 1977, Kanter had formally renounced all of his interest as a beneficiary in the Bea Ritch Trusts. At some time, many additional trusts were added as beneficiaries to the trusts. The identities of the beneficiaries of the additional trusts are not in the record. The original individual and additional trust beneficiaries of the Bea Ritch Trusts are as follows:

Original Trust Name	Additional Beneficiaries
BWK Trust	Burton Kanter JSK 1st Trust # 5 JSK 2d Trust # 5 JSK 3d Trust # 5
Naomi Trust	Naomi Kanter JSK 3d Trust # 19 JSK 1st Trust # 20
BN Trust	Burton & Naomi JSK 1st Trust # 4 JSK 2d Trust # 4

	JSK 3d Trust # 4
Joel Trust	Burton & Joel JSK 1st Trust # 17
	Kanter JSK 2d Trust # 17
Janis Trust	Burton & Janis JSK 3d Trust # 15
	Kanter JSK 1st Trust # 16
Joshua Trust	Burton & Joshua JSK 2d Trust # 18
	Kanter JSK 3d Trust # 18
Joel Children's Trust	Burton, Naomi, JSK 3d Trust # 17 Joel & Joel's JSK 1st Trust # 18 children living from time to time
Janis Children's Trust	Burton, Naomi, JSK 2d Trust # 16 Janis & Janis JSK 3d Trust # 16 children living from time to time
Joshua Children's Trust	Burton, Naomi, JSK 1st Trust # 19 Joshua & Joshua's JSK 2d Trust # 19 children living from time to time
JL-1 Trust	Burton, Joel, JSK 3d Trust # 11 Harriet Blum & JSK 1st Trust # 12 Joel's 1st child
JL-2 Trust	Burton, Joel, JSK 2d Trust # 12 Debbie Blum & JSK 3d Trust # 12 Joel's 2d child
JL-3 Trust	Burton, Joel, JSK 1st Trust # 13 Jeff Blum & JSK 2d Trust # 13 Joel's 3d child
JA-1 Trust	Burton, Janis, JSK 1st Trust # 9 Henry Krakow & JSK 2d Trust # 9 Janis' 1st child JSK 3d Trust # 9
JA-2 Trust	Burton, Janis, JSK 1st Trust # 10 Helen Krakow & JSK 2d Trust # 10 Janis' 3d child
JA-3 Trust	Burton, Janis, JSK 1st Trust # 11 Helen Krakow & JSK 2d Trust # 11 Janis' 3d child

JS-1 Trust Burton, Joshua, JSK 3d Trust # 13
Gerald L. Kanter & JSK 1st Trust # 14
Joshua's 1st child
JS-2 Trust Burton, Joshua, JSK 2d Trust # 14
Ruth Kanter & JSK 3d Trust # 14
Joshua's 2d child
JS-3 Trust Burton, Joshua, JSK 1st Trust # 15
Joshua's 3d child JSK 2d Trust # 15
& all of the
children of Gerald L.
Kanter living from
time to time
BK Children's Burton, Naomi and JSK 1st Trust # 1
Trust all of the children JSK 2d Trust # 1
of the Grantor's JSK 3d Trust # 1
son living from
time to time
BK Descendant's Burton, Naomi and JSK 1st Trust # 2
Trust all of the JSK 2d Tr . # 2
descendants of the JSK 3d Trust # 2
of the Grantor's son
living from time to
time
BK Grandchildren's Burton, Naomi and JSK 1st Trust # 3
Trust Burton's Grand- JSK 2d Trust # 3
children living JSK 3d Trust # 3
from time to time
Lillian Trust Burton, Naomi and JSK 2d Trust # 20
Lillian Walker JSK 3d Trust # 20
J-1 Wife's Trust Burton, Joel's Wife JSK 1st Trust # 6
and the children of JSK 2d Trust # 6
Carl I. Kanter JSK 3d Trust # 6
living from time
to time
J-2 Husband's Burton, Janis' JSK 1st Trust # 7
Trust husband and the JSK 2d Trust # 7
children of JSK 3d Trust # 7

Aloysius B. and
Helen M. Osowski
J-3 Wife's Trust Burton, Joshua's JSK 1st Trust # 8
wife and Ruth & JSK 2d Trust # 8
Philip Loshin JSK 3d Trust # 8

Solomon Weisgal (Weisgal), an accountant and a longtime friend and business associate of Kanter, has been the sole named trustee of the Bea Ritch Trusts since 1969. As trustee of the Bea Ritch Trusts, Weisgal had broad power either to accumulate the Bea Ritch Trusts' income or to distribute (i.e., sprinkle) the trusts' income and assets among all or any of the trusts' beneficiaries in a manner he deemed appropriate. Weisgal did not act independently as a trustee. Rather, he acted as Kanter directed in all matters regarding the trusts.

3. IRA Officers and Directors

Prior to October 27, 1975, Keating was president and secretary of IRA. On October 27, 1975, Keating resigned and Schott was elected as president and Sharon Meyers (Meyers) as secretary by the unanimous consent of the directors (Schott, Meyers, and Patricia Grogan (Grogan)). From 1977 to 1980, the president of IRA was Schott, and the vice president was Weisgal.

Lawrence Freeman (Freeman), an attorney in Miami, Florida, was a friend and business associate of Kanter. At Kanter's request, Freeman served as IRA's president from 1980 to 1989. Although Freeman was not paid for serving as IRA's president, he and his law firm received significant legal business through referrals from Kanter. In 1989, Kanter became IRA's acting president.

From 1976 through 1980, Schott, Weisgal, and Grogan served as IRA's directors. From 1981 through 1989, Freeman served as a director. For most of those years Freeman was the sole director. Although Ballard was not listed as a director, IRA paid Ballard $12,500 as directors fees in 1981. IRA deducted $12,500 as a director fee expense on its 1981 return.

Meyers served as an officer or director of IRA at various

times. Meyers originally worked as Kanter's secretary at Kanter's law firm. By the 1970's, her duties at the law firm evolved to her being an administrative assistant to Kanter. By 1981, she was no longer an employee of the law firm. During the years at issue, Meyers also served as an officer or director of many of Kanter's other corporations.

At all times, IRA's officers and directors made decisions and performed their duties in accordance with Kanter's instructions.

4. IRA Subsidiaries

IRA owned, from time to time, controlling interests in several subsidiary corporations. These subsidiary corporations included Brickell Enterprises, Inc., Cedilla Co., Cedilla Investment Co., IRA Florida Apartments, Inc., KWJ Corp., Zeus Ventures, Carlco, TMT, and BWK, Inc. IRA also, at one point, owned a majority stock interest in Int'l Films. Carlco, TMT, and BWK, Inc., were incorporated in the State of Delaware in 1982 but remained inactive until 1983. In December of 1983, IRA acquired 1,000 shares (100 percent) of the common stock of each of Carlco, TMT, and BWK, Inc. In December 1983 and January 1984, Carlco, TMT, and BWK, Inc., each issued shares of preferred stock. Carlco preferred shares were issued to the Christie Trust established by Kanter for the benefit of Lisle's family; TMT preferred shares were issued to the Orient Trust established by Kanter for the benefit of Ballard's family; and BWK, Inc., preferred shares were issued to the BK Children's Trust, the beneficiaries of which were members of Kanter's family.

C. Holding Co.

Holding Co. was incorporated on December 8, 1976. Holding Co. owned several subsidiary corporations, including the Citra Co., Active Business Corp., HELO, LBG Properties, Inc., The Nominee Corp., Oil Investments, Ltd., Tanglewood Properties, Inc., and Zion Ventures, Inc.

Kanter, his family, and trusts established for the benefit of his family, including the Bea Ritch Trusts and the Everglades Trusts, [FN8] owned substantially all of the stock in Holding

Co.

Kanter, Weisgal, Meyers, and Linda Gallenberger (Gallenberger) most often served as directors and officers of Holding Co.

Holding Co.'s end-of-year balance sheets indicate the following stockholder equity attributable to the preferred and common stock:

Year	Common	Preferred	Paid-in
	Class A	Class B	Class C	Class D	Capital	
1979	$23	$775	$3	$50,000	--	$407,087
1980	23	775	3	50,000	1,500,000	407,087
1981	23	775	3	50,000	--	407,087

Prior to August 1981, another Kanter entity, Computer Placement Services, had a $1,729,300 loan outstanding to Holding Co. In August 1981, $1,500,000 of the loan was converted to Holding Co. class D preferred stock. In 1983, the stockholder equity of class D preferred stock was decreased by $1,499,999 and the paid-in capital was increased by the same amount.

D. Administration Co. and Principal Services: The Banking Corporations

The funds of the various Kanter entities (as well as the funds of some of Kanter's associates) were commingled in accounts held by Administration Co. and later the Principal Services Accounting Corp. (Principal Services), both of which were also controlled by Kanter.

Administration Co. was incorporated in the State of Delaware on September 21, 1981, and was authorized to do business in the State of Illinois. Administration Co.'s offices were located either at Kanter's law firm offices or in close proximity thereto. [FN9]

The sole shareholder of Administration Co. was the Pyramid Trust. Weisgal was trustee of the Pyramid Trust, and Meyers

was the sole beneficiary.
Meyers was the sole director of Administration Co. and was its president from 1981 to 1985. Gallenberger was the vice president of Administration Co. and worked under the direction of Meyers. When Meyers left Administration Co. in 1985, Kanter briefly served as acting president of Administration Co., and, thereafter, Gallenberger became Administration Co.'s president from 1985 through 1988. [FN10]
Administration Co. had several employees, mostly clerical assistants, bookkeepers, and accountants. Meyers directed the staff and employees of Administration Co. until 1985. In 1983, Administration Co. paid $143,489 in employee compensation and distributed over $500,000 as nonemployee compensation, including $400,000 to the Rainbow Trusts (Rainbow Trust Nos. 1-25).
Administration Co. administered funds that it collected from or on behalf of various Kanter entities and associates, referred to as clients. Administration Co. clients included individuals (including Kanter, Ballard, and Lisle), corporations (including IRA, Holding Co ., and their subsidiaries), partnerships, trusts, various Kanter-related entities, and members of Kanter's law firm.
Administration Co. opened a bank account in Administration Co.'s name known as the Special E Account. The Special E Account functioned generally as a checking account for its various clients. Administration Co.'s books and records reflected each client's balance in the account and also reflected deposits or withdrawals affecting that client's account.
Administration Co. also maintained at its bank a second account known as the Special Account that served more like a savings or money market account. The moneys in this account were used to buy certificates of deposit because a higher rate of return could be realized by aggregating the funds to purchase larger denomination certificates of deposit.

Funds from both the Special E Account and the Special Account were lent to Administration Co. clients. Deposits to and withdrawals from the Special E Account and the Special Account were posted to the appropriate client accounts. If a client had a negative balance in the accounts, that debit amount was recorded as a receivable owed by the client to Administration Co. Any positive balance a client had in the accounts was considered money belonging to the client.
Administration Co. issued annual tax statements and reports to its clients and the Internal Revenue Service (IRS) for the interest earned by each client on that client's funds in the Special E Account and the Special Account.
Administration Co. maintained books and records for each of its clients and, in many instances, prepared clients' tax returns. Administration Co. prepared Kanter's income tax returns for all or some of the years at issue. Administration Co. charged a fee for its services.
Administration Co. filed for bankruptcy in February 1988, and Principal Services was organized. All of Principal Services' outstanding shares of stock were initially owned by ARO Trust, of which trust Kanter was the trustee.
Principal Services took over a number of Administration Co.'s clients, including Kanter, IRA, and Holding Co. Principal Services performed services for clients similar to those provided by Administration Co. Principal Services also established two accounts similar to the Special E Account and the Special Account. During the years at issue, Principal Services made loans to Holding Co. and BWK, Inc.
In 1990, Gallenberger purchased from ARO Trust all of Principal Services's shares for $100. In October of 1993, Principal Services moved (along with all of its clients files) to Wisconsin.
E. The Other Lending Corporations
During the years at issue Kanter often used two additional entities, HELO and Int'l Films to distribute funds including distributions to Ballard and Lisle or trusts established for the benefit of their families.

1. HELO

HELO's predecessor, Harbor Investments, Inc., was incorporated on July 21, 1978, and the stated business purpose was investments. The name was changed in fiscal year ending August 31, 1980, to Harbor Exchange Lending Operation. The Active Business Corp. (Active) owned 100 percent of the voting stock of HELO. Holding Co. owned 100 percent of the stock of Active and filed consolidated returns with HELO and Active.

On August 31, 1984, all of the shares of HELO were transferred by Active to Kanter as the trustee of the ARO Trusts. At the time of the transfer, HELO's only significant assets were loan receivables totaling $2,331,326, and its liabilities included short-term loans of $2,518,589 and long-term loans of $10,557. Holding Co. also disposed of 100 percent of the voting stock of Active Corp. in 1984.

Holding Co.'s consolidated returns reported the following income, net assets, and stockholder equity with respect to HELO: [FN11]

	08/78	08/79	08/80	08/81	08/83	08/84
Income	--	--	$1,485	$4,597	--	$136
Deductions	--	($115)	(31,309)	(149,974)	--	(30)
Total	--	(115)	(29,824)	(145,377)	--	106
NOL	--	(115)	(29,939)	--	(198,135)	
Taxable	--	(29,939)	(175,316)	--	(198,029)	
Assets						
Cash	$500	131	4,294	(879,704)	$31	322
Receivables	--	--	2,871,082	4,69 1,912	2,331,326	1,320,059
Money market	--	--	718	259	--	--
Pooled funds	--	--	--	--	--	4,636
Intangibles	151	120	89	27		

Total	500	382	2,876,214	3,812,55 6	2,331,384	1,325,017
Liabilities						
Short term	--	--	322,987	849,680	2,518,589	1,522,700
Shareholder	--	--	1,255,600	10,557	--	--
Long term	--	--	1,327,100	3,127,200	10,557	
Total	--	--	2,905,687	3,987,437	2,529,146	1,522,700
Net assets	500	382	(29,473)	(174,881)	(197,762)	(197,683)
500						
Capital stock	500	500	500	500	500	
Ret. earnings	(118)	(29,973)	(175,381)	(198,262)	(198,183)	

2. Int'l Films

Int'l Films was incorporated in September 1973. Although the record does not disclose who originally owned the stock of Int'l Films, on August 31, 1984, IRA owned 71 percent of the voting stock of Int'l Films. As of August 31, 1983, Int'l Films had loans receivable of $878,227. As of August 31, 1984, Int'l Films had loans receivable of $1,050,827.

III. Transactions Involving the Five

Prior to and during the years at issue, Prudential was one of the largest holders of commercial real estate in the United States. By the late 1970's, Prudential either held or was responsible for managing an estimated $20 billion in commercial real estate properties. Prudential also developed commercial real properties and provided financing to other real estate developers for various real estate projects around the country.

As stated previously, Kanter entered into arrangements pursuant to which he would use his relationships with the Pritzkers, Ballard, and Lisle to assist individuals and/or entities in obtaining business opportunities or in raising capital for business ventures. Some of these arrangements involved payments by a group of individuals referred to by the parties as "the Five". The Five include J.D. Weaver (Weaver), Bruce Frey (Frey), William Schaffel (Schaffel),

Kenneth Schnitzer (Schnitzer), and John Eulich (Eulich).

A. The Weaver Arrangement: Hyatt Corp.'s Embarcadero Hotel Management Contract

Hyatt Corp. manages hotels in the United States, Canada, and the Caribbean. As indicated previously, members of the Pritzker family control Hyatt Corp. Kanter has represented the Pritzkers for years as their attorney.

The Houston Hyatt Hotel was co-owned by Prudential and Tenneco Corp. (Tenneco) and managed by Hyatt Corp. Weaver was an executive with Tenneco. From 1968 through 1972, Ballard and Weaver were involved in the development of the Houston Hyatt Hotel, and Ballard negotiated the hotel's management contract with Hyatt Corp.

During the early 1970's, Prudential was also a participant in a joint venture to develop and own the Embarcadero Hotel in San Francisco. The joint venture participants sought an experienced major hotel management company to operate the hotel under a long-term management contract. Del Webb (Webb), a well-known hotel operator and owner of a large hotel management company, and Intercontinental Co., another large hotel management company, were competing for the management contract. A.N. Pritzker wanted the Hyatt Corp. to obtain the management contract for the Embarcadero Hotel; the hotel would become the third or fourth Hyatt-operated hotel in the United States at which major conventions could be held.

Lisle was supervising development of the Embarcadero Hotel for Prudential and was involved in the selection of a management company to manage the hotel. Although Hyatt Corp. was about to enter into the long-term management contract to operate the Houston Hyatt Hotel owned by Prudential and Tenneco Corp., Lisle was not interested in having the Hyatt Corp. manage the Embarcadero Hotel. Pritzker offered to pay Weaver, who had worked with Ballard in developing the Houston Hyatt Hotel, a portion of the management fees if Weaver helped Hyatt Corp. obtain the management contract for the Embarcadero Hotel.

Weaver then persuaded Lisle to consider Hyatt Corp. for the Embarcadero Hotel's management contract.

Since Ballard had negotiated the Houston Hyatt Hotel's management contract, Knab (Ballard and Lisle's superior at Prudential) directed Ballard to review and evaluate the terms of the proposed management contracts to be considered for the San Francisco Embarcadero Hotel. Subsequently, representatives of the Embarcadero joint venture participants met with Webb and Pritzker to obtain bids on the Embarcadero Hotel's management contract. Ballard and Lisle, as well as other Prudential employees, represented Prudential at the meeting. For reasons not fully shown in the record, representatives of Intercontinental Co. were not present at the meeting, and Webb refused to submit a bid during the meeting because he thought he had been promised the contract. Pritzker offered to have Hyatt Corp. enter into a management contract for the Embarcadero Hotel substantially similar to the Houston Hyatt Hotel's management contract. At the meeting Hyatt Corp. submitted the only bid, and the management contract was awarded to Hyatt Corp.

Shortly after being awarded the contract, Hyatt Corp. entered into an agreement with KWJ Corp., an S corporation solely owned by Weaver. Under the written agreement dated February 25, 1971, Hyatt Corp. agreed to pay KWJ Corp. a commission generally equal to 10 percent of Hyatt Corp.'s fees under the Embarcadero Hotel management contract. The agreement acknowledged that "KWJ" was the principal factor in bringing Hyatt Corp. and the owners of the Embarcadero Hotel together and aiding in the negotiations.

Over the period from about 1972 through 1994, Prudential eventually built a total of about 10 large, major-convention-size hotels that Hyatt Corp. managed for it. During discussions about Hyatt Corp.'s obtaining the management contract on one of the first of these other hotels built after the Embarcadero Hotel, Pritzker discussed Weaver's finder's fee

with respect to the Embarcadero Hotel's management contract with Ballard and Lisle. Pritzker told Ballard and Lisle that Hyatt Corp.'s payment of this finder's fee was a one-time occurrence. Pritzker told them that no similar finder's fees would be paid with respect to future management contracts that Hyatt Corp. obtained for other Prudential hotels.

The Embarcadero Hotel opened in May 1973. In early 1975, a dispute arose between Weaver and Hyatt Corp. with regard to the commission due for 1974. A Hyatt Corp. official informed Weaver that the Embarcadero Hotel did not generate a net profit for 1974. Weaver claimed that Hyatt Corp. was entitled to $623,201 under its agreement with Prudential and that he was entitled to 10 percent of those fees. Pritzker responded that Weaver's share of the fees should bear his share of the home office expenses. By November of 1975, Weaver and Hyatt Corp. had settled the dispute.

During the period when Weaver and Hyatt were disputing the computation of Weaver's share of the management fees, Kanter and Weaver agreed that IRA would purchase the stock of KWJ Corp. In a letter to Kanter dated March 10, 1976, Weaver confirmed "our understanding regarding my granting to your client a right to purchase all of the outstanding shares of stock of KWJ Corp." for $150,000. The letter further provided that in addition to the purchase price for the KWJ Corp. stock, KWJ Corp. would continue to engage Weaver as its president and chief operating officer. In addition, Weaver was to receive 30 percent of all payments made by Hyatt Corp. under the contract with KWJ Corp. for as long as the contract was in existence, regardless of whether he performed any services for KWJ Corp.

At that time, Hyatt Corp. was in the process of becoming privately owned, and Kanter did not want the transfer of the KWJ Corp. stock to take place until after Hyatt Corp. became privately owned. Therefore, the agreement was framed as an offer to sell the stock for a period of 4 years.

On March 14, 1977, Hyatt Corp. paid KWJ Corp. $54,848 for fees earned during 1976. Sometime prior to November 1978, Hyatt Corp.'s management contract with the hotel was modified, and Hyatt Corp. wanted to revise its agreement with KWJ Corp. By letter dated November 14, 1978, Hyatt Corp. notified Weaver that, under the proposed change, KWJ Corp. would have been overpaid by $54,848 for 1976 and would be due $12,095 for 1977. By letter dated November 21, 1978, Weaver informed Kanter of the proposed changes in the Hyatt arrangement. The letter indicated that Weaver would call Kanter to discuss the proposed change. In a letter to Hyatt Corp. dated November 30, 1978, Weaver stated that the KWJ Corp. contract would not be affected by any modifications to Hyatt Corp.'s Embarcadero Hotel contract. On December 12, 1978, Hyatt Corp. paid KWJ Corp. $60,739 for 1977.

In February 1979, Hyatt Corp. had become a privately owned entity. By letter dated September 27, 1979, Kanter informed Weaver that Kanter wanted to proceed with the purchase of the KWJ Corp. stock, effective retroactively to November 1, 1978. IRA purchased 100 percent of KWJ Corp.'s outstanding shares of stock from Weaver. IRA was to pay $10,000 of the purchase price in November 1979 and the balance by August 1980.

As a result of IRA's purchase of the KWJ Corp. stock, KWJ Corp. was included as a subsidiary on IRA's 1979 consolidated return. The 1979 consolidated return reported KWJ Corp.'s 1979 gross receipts of $171,027 and payment of the 30 percent fee to Weaver of $51,308. The 1979 consolidated return reflected KWJ Corp.'s assets, liabilities, and net worth as of January 1, 1979, as follows:

Assets
Cash $40,626
Accrued income 108,521

Total assets 149,147

Liabilities
Mortgages, notes, and bonds payable 19,400
Accrued expenses 14,663

Total liabilities 34,063

Net Worth 115,084

Common Stock 1,000
Retained earning unappropriated 53,968
Previously taxed income 60,116

Total stockholder equity 115,084

The commissions paid over by Hyatt Corp. attributable to operations from 1978 through 1982 were as follows:

Operating Year	Payment Year	Payment
1978	1979	--
1979	1980	$171,027
1980	1981	128,671
1981	1982	246,717
1982	1983	245,843

Except for the $171,027 payment received in 1980 from operations of the Hyatt hotel during 1979 that it reported on its 1979 return, IRA included the payments as income on the returns for the years of payment.
Hyatt Corp. was not informed about the sale of the KWJ Corp. stock to IRA and, therefore, continued to send the payments to Weaver, who then sent the check to IRA. IRA then paid Weaver his 30 percent and deducted the payments as a commission expense.
A letter dated March 29, 1983, from Weaver to Kanter states:
Attached is the check from the Hyatt Corporation in the

amount of $245,843.00, which represents K.W.J.'s commission for the year ending December 31, 1982.
Will you please deposit and issue appropriate checks to the participants.
This represents approximately the same amount as last year, per the attached balance sheet.
By August 1983, Weaver advised IRA that he wanted to modify his arrangement with KWJ Corp. The new arrangement provided that Weaver could retire from any and all activities with respect to KWJ at any time after December 31, 1983. Weaver would continue to receive 30 percent of any amount received by KWJ Corp. from Hyatt Corp. with respect to the management contract of the Embarcadero Hotel. Weaver's 30-percent interest would pass to his estate or such other specific persons as he might designate in writing.
In December 1983, KWJ Corp. was liquidated, and its assets were distributed to IRA. On January 2, 1984, IRA's new subsidiaries BWK, Inc. (managed by Kanter), Carlco (managed by Lisle), and TMT (managed by Ballard) formed a partnership called KWJ Co. (KWJ Co. partnership). Carlco and TMT each had a 45-percent interest in the KWJ Co. partnership, and BWK had a 10-percent interest in the partnership. Hyatt Corp. was not informed about the liquidation of KWJ Corp. or the formation of the KWJ Co. partnership at the time of the liquidation and formation. Hyatt Corp. continued to send payments to Weaver until Kanter notified Hyatt Corp. sometime around 1992.
From 1984 through 1989, Hyatt Corp. paid the following commissions with respect to the Embarcadero Hotel that were reported as income of the KWJ Co. partnership:

Operating Year	Payment Year	Payment
1984	1985	$295,415
1985	1986	330,376
1986	1987	327,784

1987 1988 281,926
1988 1989 75,396
1989 1990 24,340

The KWJ Co. partnership paid Weaver his 30 percent and deducted the payment as a commission expense.
B. The Frey Arrangement: Condominium Conversions.
Bruce Frey (Frey), was a certified property manager, real estate broker, and insurance broker. Frey began working at the real estate firm of Downs, Mohl & Co. in 1965. While at Downs, Mohl & Co., Frey met Kanter. In the early 1970's, Frey formed D.M. Interstate, Inc., a real estate management company that was an S corporation. In 1975, James Wold (Wold), became a shareholder and employee of D.M. Interstate, Inc. Sometime later, Frey also formed BJF Development, Inc., a corporation that engaged in real estate development and management. Frey was the sole shareholder of BJF Development, Inc. Hereinafter, D.M. Interstate, Inc. and BJF Development, Inc., are each sometimes referred to as a Frey corporation.
In 1978 or 1979, Frey began converting rental property into condominiums. Frey or a Frey Corporation purchased rental property, refurbished it, and then sold the individual units as condominiums. Frey or a Frey corporation earned development fees for managing and supervising the renovation and conversion work on the property. A condominium project typically involved the use of a limited partnership. As a partner in the partnership, Frey or a Frey corporation would also receive profit distributions that were based upon sales of condominiums. Frey or his Corporation also earned management fees for their services in managing the condominium units following the conversion.
Frey's first condominium conversion project was called Moon Lake Village and involved an apartment building located in Hoffman Estates, Illinois. A joint venture limited partnership was formed to purchase the apartment building and convert it to condominiums. Frey was the general

partner in the partnership and there were several investors who made contributions to the partnership. A Frey corporation received development fees, profit participation, and management fees in the Moon Lake Village project. Neither Kanter nor Prudential was involved in the Moon Lake Village project.
After successfully engaging in the Moon Lake Village conversion in 1978, Frey met and consulted with Kanter to obtain tax advice in connection with that project. During their meeting or shortly thereafter, Frey and Kanter discussed Frey's need to raise capital for future condominium conversion projects. At that time, condominium conversions were occurring frequently in metropolitan areas throughout the country, and Frey was faced with having to raise capital to acquire and convert apartment building properties in which he and other competing condominium converters were interested. Although Frey generally could obtain financing from a bank for most of a condominium conversion project's cost, the bank usually required Frey and other investors to have a substantial investment in the project. Kanter said that he could help raise some of the capital Frey needed for the condominium conversion projects. In consideration for such assistance, Kanter required Frey to share the development and management fees that Frey earned from such projects. Frey agreed to pay Kanter a share of the development and management fees if Kanter caused a third party to invest money in a project. Furthermore, if Kanter invested in a conversion project, he would also share in the profit participation of the partnership.
From 1978 to 1987, a number of condominium conversion projects were undertaken by limited partnerships that Frey and the Frey corporations formed with other investors. Frey or a Frey corporation often served as the general partner in such limited partnerships. In many instances, the limited partnerships acquired an apartment complex, renovated and converted it into condominium units, and sold the

condominium units to individual purchasers.
Beginning with Frey's second condominium conversion project, entities associated with Kanter received limited partnership interests in many of Frey's condominium conversion projects. The Kanter entities that received such partnership interests included Zeus Ventures, Inc. (Zeus), a subsidiary of IRA, and Zion Ventures, Inc. (Zion), a subsidiary of Holding Co. Kanter also brought other investors into some of Frey's condominium conversion projects for which Kanter entities received a share of development and management fees. Projects in which Kanter entities received fees or interests included the Lakewood Associates project and the 535 Michigan Avenue project.
The first condominium conversion project that Frey undertook involving Prudential was a 1,000-unit townhouse apartment complex called Village of Kings Creek at Miami, Florida. About 1979, Frey approached a Prudential real estate department executive working in Prudential's Miami, Florida, regional office about purchasing the Village of Kings Creek apartment complex. The apartment complex was owned by a pension fund managed by Prudential. Frey offered to purchase the apartment complex for a cash price of about $20 million. He also advised the Prudential executive that Connecticut Mutual Life Insurance Co. would be joining Frey in purchasing the property. Prudential previously had considered selling the apartment complex, and Frey's $20 million offer for the property significantly exceeded the property's appraised market value.
The Prudential executive consulted with Ballard about Frey's offer. Ballard thought that Prudential's refusal of such offer might constitute a breach of fiduciary duty as investment manager of the pension fund. Ballard advised the executive that Prudential should accept the offer.
On January 16, 1980, the Village of Kings Creek partnership was formed for the purpose of purchasing the property from Prudential and converting it into condominiums. In 1980, the

Village of Kings Creek apartment complex was sold by Prudential to the partnership. Zeus (a subsidiary of IRA) and Zion (a subsidiary of Holding Co.) became limited partners in this limited partnership. Kanter also brought in another investor, First Illinois Enterprises (an Illinois general partnership), that invested $1.5 million in the project. The financing for the Village of Kings Creek project came from the following sources: The First National Bank of Chicago was the first mortgage lender; Connecticut Mutual Life Insurance Co. and First Illinois Enterprises were the two primary equity participants.
Under the partnership agreement, Zeus was required to make an initial contribution of $100,000 for its 6.14-percent interest in the partnership. Zion was required to make an initial contribution of $108,014 for its 6.66-percent interest in the partnership. In the event of certain circumstances, the partners agreed to make additional contributions to the partnership. The partnership agreement provided that the partnership would reimburse or credit the capital accounts of the Frey corporation, Frey, Wold, and Zion for "the advances made by them in negotiating, entering into and performing the terms and conditions of Purchase and Sale Contract and Contractual Commitments".
Following Prudential's sale of the Village of Kings Creek property, the executive in the Miami regional office who had dealt with Frey in the sale approached Frey about converting another Prudential apartment property in Florida into condominiums. Beginning with this property, Prudential participated in a number of successful condominium conversion projects with Frey. Most of these projects that Frey and Prudential undertook were joint ventures.
Frey did not have to raise much capital to engage in these joint venture projects with Prudential, because Prudential owned the apartment property to be converted and participated as co-owner in a joint venture to convert and sell the property as condominium units. Prudential would contribute the property and receive (1) all initial

condominium unit sale proceeds up to a specified amount based, in large part, on the property's appraised fair market value as a rental property, and (2) 50 percent of all other unit sale proceeds above the initial specified amount. A limited partnership received 50 percent of the proceeds above Prudential's initial specified amount of the proceeds from the sale of units. A Frey corporation was responsible for renovating and converting the property and selling the condominium units in exchange for development fees and management fees from the owners of the condominiums for managing the property after the conversion. Some of the Frey-Prudential agreements included the Calais and Chatham agreements, both dated August 1, 1981, the Valleybrook agreement dated October 1, 1981, Old Forge agreement entered into prior to October 12, 1981, and The Greens agreement entered into prior to December 30, 1981. Frey's agreement that he would share development and management fees with Kanter entities was formalized in two separate written agreements each dated October 12, 1981. One agreement was between Frey and IRA's subsidiary Zeus, and the other agreement was between Frey and Holding Co.

The written agreement with Zeus covered development fees from projects in which Prudential apartment properties were being converted. The letter agreement, from Frey to Meyers (president of Zeus), referred to Zeus' "Participation in Proceeds on Prudential Conversions" and provided:

As requested, we are writing to confirm our prior agreement regarding the participation in the amounts realized or to be realized on the condominium conversion of properties of or for The Prudential Insurance Company of America ("Prudential").

The terms of this letter agreement shall apply with respect to all conversions of Prudential properties heretofore and hereafter.

As used in this letter agreement, the term "amounts realized" includes all amounts to be received by the converter as

Developers' Fees and shares of assigned profits but excluding any management or other fees (which shall be retained by the Manager). * * *

* * *

Of the amounts received as a Developers' Fee on Prudential conversions, BJF (or its counterpart in any future conversion) shall retain 75% of the amount received in reimbursement for any costs and expenses paid or incurred by it. BJF shall retain this 75% amount without regard to the actual amount of its costs and expenses and without any need to account for the same. Of the remaining 25%, BJF SHALL RETAIN 80% and shall distribute the remaining 20% to you.

Of the amounts received as shares of assigned profits, BJF shall distribute 20% to you and retain the balance. BJF shall retain amounts under this letter agreement for itself and for distribution to its affiliates in such percentages as they have agreed.

BJF shall make all distributions to you not later than 30 days after the date of this letter or receipt from Prudential of the Developers' Fees and assigned profits (as the case may be).

Pursuant to this letter agreement, the BJF corporation paid the following amounts to Zeus during the years 1980 through 1985:

Year	Zeus
1980	$127,372
1981	105,764
1982	538,781
1983	110,125
Total	882,042
1984	103,500
1985	128,763
Total	232,263

The second letter agreement was from Frey to Kanter as president of Holding Co. and specifically excluded developers' fees from projects involving Prudential properties (covered in the Zeus agreement) but included other amounts related to projects involving Prudential. The letter agreement referred to "Participation in Condominium Conversions" and provided:

As requested, we are writing to confirm our prior agreement regarding the participation by us and our affiliates in capital contributions, profits and losses and Developers' Fees (excluding Developers' Fees in condominium conversions of properties of or for The Prudential Insurance Company of America and excluding legal, management or any other fees, which shall be retained by the recipients) in condominium conversions of properties.

The provisions of this letter agreement shall apply in the case of condominium conversions of those properties listed below and any other condominium conversions in which we agree to participate. Each of us may terminate this agreement at any time on forty-five (45) days or more prior written notice. The termination, however, shall be effective only with respect to new condominium conversions (i.e . conversions of properties not under discussion between us or otherwise in process on the last day of the forty- five (45) day period). The participation in capital contributions and profits and losses shall be as follows:

The Holding Company, a Delaware corporation, its nominees and/or affiliates--("THC") 33%

Bruce J. Frey and his nominee and/or affiliates--("BJF") 67%

The participation in Developers' Fees shall commence with respect to fees received after October 1, 1981, and shall be as follows:

Holding Co. 5%
BJF 95%

100%

As used herein, the terms capital contributions, profits and losses and Developers' Fees refer to those items allocated or allocable to us and our affiliates.

The properties presently subject to this letter agreement are those properties which we are converting as consultant to the Prudential Insurance Company of America. As you know, we are, of course, also participating as partners in various other condominium conversions (e.g. 535 N. Michigan Ave. Condominium, Lake Howell Condominium, etc.), but our agreements in those instances are subject to the terms of various limited partnership agreements.

Pursuant to this second letter agreement, the Frey corporation paid to Holding Co. $80,616 as a distribution in 1981 and $16,200 from participation in fees in 1983. Payments made in 1982 are not in the record.

On June 15, 1984, BJF Development, Ltd. (the Frey partnership), an Illinois limited partnership, was formed. Frey, Wold, and the Frey corporation were the general partners of the Frey partnership. The limited partners were TSG Holdings, Inc., FWID, Ltd., and Holding Co. Under the partnership agreement Holding Co. was entitled to distributions of 13.125 percent of available cash- flow. Generally, the purpose of the partnership was to conduct business activities related to development of condominiums and cooperatives and property management.

TSG Holdings, Inc. contributed $750,00 to the Frey partnership. Transcontinental Services Group, N.V., a Netherlands Antilles corporation and TSG Holdings, Inc.'s parent corporation, lent $1.75 million to the Frey partnership.

In addition to other assets contributed to the Frey

partnership, the remaining partners assigned their right to receive fees under other management, consulting, and/or partnership agreements, including the Village of Kings Creek, Lakewood, Calais, Chatham, Valleybrook, The Greens, and Galaxy Towers that had previously been subject to the letter agreement between Holding Co. and the Frey corporation. The partnership agreement also listed two participation agreements with "Burton J. Kanter" regarding certain condominium conversions. The agreement indicated that the two participation agreements had been canceled with respect to new condominium conversions.

A letter dated June 20, 1984, to Kanter described Holding Co.'s obligation to contribute to the capital of the partnership as follows:

With the recording of the Certificate of Limited Partnership, The Holding Company should:

a. make its cash capital contribution of $29,913.80 to the Partnership;

b. pay FWID, Ltd. ("FWID"), $86,789.57 for contributing cash equivalents to the Partnership on its behalf;

c. issue a $88,387.46 secured note to FWID for contributing other assets to the capital of the Partnership on its behalf; and

d. confirm its agreement to remit to FWID its share of Partnership distributions resulting from the Partnership's realization of the fees and profits shown on Part II of Appendix A.

The parties contributed a total of $170,936 in cash to the capital of the Partnership. See item 8 of Part 1 of Appendix A. Of this amount, The Holding Company is responsible for 17-1/2 percent or, as shown above, $29,913.80.

The parties contributed a total of $495,940.31 in cash equivalents to the Partnership. The Holding Company's share of this amount is, as noted above, 17- 1/2 percent or $86,789.54. The cash equivalents consist of the items shown as numbers 6, 7, and 9 on Part I of Appendix A. The items are:

6. October 31, 1983, Agreement with Lazard Freres & Co. $273,547.00

7. April 14, 1983, Real Estate Sale Agreement as amended with 211,082.00
Norman Rudenberg and Edna Davidson

9. Furniture, fixtures, and equipment 11,311.31

Total $495,940.31

As shown in the enclosed chart, The Holding Company's remaining obligation for capital contributions to the Partnership was $145,798 .66. Of this amount, The Holding Company satisfied $57,409.20 by the transfer to the Partnership of a 20 percent interest in the $287,046 of purchase money mortgages relating to the condominium units at 535 North Michigan Avenue. Accordingly, after satisfying its share of the cash capital contributions, The Holding Company's remaining obligation to FWID is $88,387.46.

The Holding Company now should satisfy its obligation for the cash contribution to the Partnership by transferring $29,913.80 in cash to it. The Holding Company should satisfy its obligation to FWID for the transfer of the cash equivalents by paying FWID $86,789 .54. In addition, The Holding Company should satisfy its responsibility for the balance of $88,387.46 by signing a note for this amount payable to FWID and pledging as security either third- party paper or other acceptable collateral.

The note should provide for cash payments as the Partnership realizes cash from the capital contributions to it.

I believe that you should discuss the procedures regarding the issuance of the $88,387.46 secured note with Jim Wold or, in my absence, my associate, Claire Pensyl.

The remaining item is, as noted above, for The Holding Company to confirm its agreement to remit its share of Partnership distribution to FWID. The Holding Company's agreement is to remit distributions (a) only after The Holding Company has received Partnership distributions equal to The Holding Company's original capital contribution of $262,500 and (b) then only in an amount equal to 13.125 percent of the amount realized by the Partnership from all the items shown on Part II of Appendix A. The 13.125 percent equals The Holding Company's share of all Partnership distributions under Section 3.2 of the Agreement of Limited Partnership.

In January 1985, approximately 6 months after the formation of the partnership, TSG Holdings purchased additional interests in the Frey partnership for $1,382,575, of which $241,950 was payable to Holding Co. The purchase price was paid to Holding Co. in two installments. The letter dated January 8, 1985, accompanying the first installment provided as follows:

Enclosed is FWID, Ltd. check number 113 in the amount of $66,507 .00. This check represents your allocable share of the above-mentioned transaction after reducing your loan from Bruce Frey by one-half, or $44,194.00.

The following is a brief analysis of the transaction, your allocable share and a calculation of the manner in which check number 113 was derived:

1. Gross Sales Price $1,382,575

2. Ownership Percentage of BJF Development, Ltd. (11.1895 divided 17.5
by 63.94 percent)

3. Allocable Share of Gross Sales Proceeds 241,950

4. Sales Proceeds Received to Date 632,575

5. Allocable Share of Sales Proceeds Received to Date 110,701

6. Less: One-Half of Outstanding Loan from Bruce Frey
($88,388 .00 44,194
divided by 2)
---

7. Check Number 113 $66,507

The letter dated January 24, 1985, accompanying the second installment provides as follows:

Enclosed please find check number C 1148 in the amount of $131,250.00. This check represents the second and final installment payment with regard to your sale of partnership interest in BJF Development, Ltd. to TSG Holdings.

The entire second installment payment to the selling partners was $750,000.00. Your allocable share of the transaction was 17.5 percent, thus equaling the $131,250.00.

From 1984 through 1987, the Frey partnership paid a total of $403,954 to Holding Co. ($113,827 in 1984, $256,557 in 1985, and $33,570 in 1987). Of the $113,827 paid in 1984, $98,437 was identified as a distribution and $25,391 as Holding Co.'s share of fees. Of the $256,557 paid in 1985, $197,757 was Holding Co.'s share of proceeds from the sale of the additional partnership interest to TSG Holdings, $55,950 as a distribution, and $2,850 represented participation in developers' fees.

C. The Schaffel Arrangement: Real Estate Construction and Financing

Schaffel was a mortgage broker and a real estate developer. In the summer of 1979, Kanter invited Schaffel to dinner at a New York City restaurant to discuss a business proposition. He told Schaffel that Ballard and Lisle would also be joining them for dinner. Schaffel accepted Kanter's invitation. In addition to learning more about the potential business opportunity that Kanter had mentioned, Schaffel was eager to meet and socialize with Ballard and Lisle, as he knew that

they were senior Prudential real estate executives.
During the dinner, Kanter asked whether Schaffel would be interested in arranging the financing for a casino hotel to be built in Atlantic City, New Jersey. Prudential was not involved in that project. Kanter offered to introduce Schaffel to the people who wanted to build the casino hotel provided Schaffel would agree to pay to one of Kanter's entities 50 percent of Schaffel's brokerage fee earned in the transaction. Schaffel agreed to pay the fee to an entity that held a real estate brokerage license. The casino hotel project, however, never materialized.
Although the casino hotel project fell through, Schaffel agreed to share certain finder's fees with Kanter in other projects. With Kanter's "concurrence", Schaffel negotiated a finder's fee arrangement with Benedict Torcivia (Torcivia), [FN12] the sole shareholder of Torcon, Inc. (Torcon). At the time, Torcon was probably the largest general contracting company in New Jersey. By letter agreement dated July 23, 1979, Torcivia agreed to pay Schaffel a fee for any construction projects that Schaffel helped obtain for Torcon. The agreement reached between Kanter and Schaffel as applied to Schaffel's arrangement with Torcon was set forth in a letter agreement with IRA dated August 2, 1979, as follows:
The purpose of this letter is to confirm that I will pay you fifty (50%) percent of any fees received by me with respect to construction jobs obtained for Torcon, Inc. in which I determine that you or your associates have been instrumental or helpful. My arrangement with Torcon, Inc. concluded with your concurrence that said Company will pay to me one (1%) percent based on the gross amount of the contract price of any such construction job. It is our understanding that you will receive payment ordinarily over a period of time depending on draws under the construction job. Accordingly, you will expect to receive payment only as I am paid.
It is further understood that the foregoing pertains only to

negotiated contract situations and should any bid situation arise, the amount of your participation will be negotiable.
Schaffel also entered into a finder's fee arrangement with William Walters (Walters), a real estate developer in Denver, Colorado, similar to the one with Torcivia, and agreed to share those fees with IRA.
1. Schaffel/Prudential Transactions
As a result of his introduction to Lisle and Ballard, Schaffel began doing millions of dollars' worth of business with Prudential. These business dealings included construction contracts that he helped obtain for Torcon and financing for a number of large commercial real properties being developed by Walters, as well as transactions involving others.
The first transaction Schaffel negotiated with Prudential was the sale of the IBM headquarters building in Lexington, Kentucky. The property was brought to Schaffel's attention by Transatlantic Consultants (Transatlantic), the company brokering the sale. Schaffel introduced the Transatlantic representative to Ballard. After the initial meeting with Ballard, Transatlantic dealt with Prudential's local office in Kentucky. Seven months after the initial meeting with Ballard, Prudential bought the building. Schaffel received a fee from brokering the sale of the building and paid half of the fee to IRA.
Some of the projects Schaffel assisted Torcivia in obtaining with Prudential included the Parsippany Business Campus, the Parsippany Hilton Hotel (located outside of Newark, New Jersey), the Gateway (located in Newark, New Jersey), and the Interplex Complex (located in Princeton, New Jersey).
Walters agreed to pay Schaffel a finder's fee with respect to two joint ventures that Walters helped negotiate with Prudential. Schaffel entered into separate written agreements dated October 19, 1981, with Cherry Creek Place Associates II (Prudential funding of $15.6 million) and Aurora Plaza & Conference Center, Ltd. (Prudential funding

of $17 million), with respect to the joint ventures. In each agreement, the partnership acknowledged that Prudential's participation in the venture was primarily the result of Schaffel's efforts and that Schaffel was entitled to be compensated.

From 1979 through 1983, pursuant to his arrangement with Kanter, Schaffel shared with IRA fees from these business deals with Prudential. Schaffel paid the following amounts from Prudential transactions to IRA from 1979 through 1983:

Year	Amount
1979	$100,000
1980	244,920
1981	361,525
1982	447,450
1983	30,981
Total	1,184,876

After Ballard and Lisle left Prudential, Schaffel no longer negotiated any transactions with Prudential.

2. Schaffel/Travelers Transactions

Lisle left Prudential in late 1981. He was employed by Travelers from April 1982 until April 1988. After Lisle began working for Travelers, Schaffel met with Lisle and others from Travelers. Thereafter, Schaffel began brokering substantial business dealings with Travelers on behalf of Torcon and Walters.

The first project Walters entered into with Travelers was Stanford Place II. By check dated November 9, 1983, Schaffel paid IRA $213,750 of the fee earned from Stanford Place II. After that payment, Schaffel stopped paying IRA a share of the fees earned on business deals with Travelers. Sometime during 1984, Kanter contacted Schaffel and asked why IRA was not receiving 50 percent of Schaffel's fees on Travelers transactions. Schaffel took the position that the August 2,

1979, agreement did not apply to deals with Travelers after Lisle had left Prudential. Kanter disagreed and maintained that the August 2, 1979, agreement continued to apply.

In a letter dated August 28, 1984, to Schaffel, Kanter stated:

I am bothered by your failure to respect what I would have considered the essential intent of the agreement you entered into vis-a-vis the introduction of you to Prudential and the arrangement under which you would share the benefits of that introduction in connection with real estate transactions from which you were able to earn commissions, as well as the other construction contracts won by Ben [Torcivia].

I appreciate that there may be some technical difficulty with the previous agreements as to whether they extend in the new circumstances to Travelers. However, in my view Travelers has replaced Prudential as a principal source of transactions because of the very personnel to whom you were first introduced. Accordingly, I am inclined to believe that the arrangement should have been continued.

Lisle and Schaffel discussed the dispute between Schaffel and Kanter. Lisle feared a lawsuit might result, and because such a lawsuit might cause some embarrassment for Lisle at Travelers, he urged Schaffel to settle the dispute.

Schaffel agreed to resume paying 50 percent of his fees on business deals with Travelers. Those fees, however, were paid to Holding Co. rather than IRA.

For some of the Walters projects brokered by Schaffel, Travelers entered into joint venture agreements with Walters' company pursuant to which Walters' company contributed the property and Travelers provided the financing. Travelers entered into joint ventures with Walters' company for the permanent financing of Stanford Place II (Travelers provided $15 million plus a $31.5 million loan), Cherry Creek National Bank (Travelers provided $8.25 million plus a $19.95 million loan), the Stanford Corporate Center (Travelers provided $43,612,622), and Boettcher Building (a.k.a the Boston Building) (Travelers' contribution to this project is not reflected in the record). For other

Walters projects brokered by Schaffel, Travelers provided financing without becoming a partner in the underlying joint venture. These projects included Orchard Place VIII (Travelers provided a $9 million loan), Orchard Place VII (Travelers provided a $8.5 million loan), and Cherry Creek Place III (Travelers provided a $10.8 million loan).
From 1984 through 1986, Schaffel paid a share of his fees on Walters-Travelers transactions to Holding Co. in the following amounts:

Year	Amount
1984	$600,000
1985	1,160,000
1986	1,003,500
Total	2,763,500

3. FPC Subventure Associates Partnership
On March 21, 1980, Kanter acquired an 8-percent limited partnership interest in Four Ponds Center Associates (Four Ponds), a joint venture involving Schaffel and Torcivia. On his 1980 Federal income tax return, Kanter reported his share of the partnership's losses.
The FPC Subventure Associates partnership (FPC Subventure) was formed as of January 1, 1981. The partners of FPC Subventure and their respective interests were: Lisle, 90 percent; the Everglades Trust (Roger Baskes, trustee), 9 percent; and Burton W. Kanter Revocable Trust (Kanter trustee), 1 percent. On January 1, 1981, Kanter transferred his 8-percent interest in Four Ponds to FPC Subventure, effectively transferring 90 percent of his interest in Four Ponds to Lisle in exchange for a receivable of $2,880 from Lisle.
A joint venture called One River Associates (One River) was formed as of November 16, 1981. Schaffel and Torcivia were

the general partners. Kanter held an 8-percent interest in One River. On January 1, 1982, Kanter transferred his interest in One River to FPC Subventure in exchange for a $2,000 receivable from FPC Subventure. Beginning in 1982, the 8-percent interest in One River held by Kanter was treated as held by FPC Subventure, and 90 percent of the income, loss, and distributions were allocated to Lisle.
On April 5, 1982, Four Ponds distributed $400,000 to Kanter. Kanter treated the distribution as a distribution to FPC Subventure. FPC Subventure retained $5,000 and distributed $395,000 to the partners, 90 percent to Lisle and 10 percent to the Kanter trusts. An additional $33,600 was distributed by Four Ponds to FPC Subventure through Kanter during 1982. During 1982 Lisle received total distributions of $384,840 from FPC Subventure. Kanter and Lisle reported on their tax returns their respective distributive shares of the FPC Subventures' partnership's income and losses.
D. The Schnitzer Arrangement: Sale and Repurchase of Property Management Systems Stock.
During the 1960's and 1970's, Schnitzer was a major real estate developer in the Houston, Texas, area. Schnitzer met Ballard and Lisle when they worked in Prudential's regional office in Houston, probably in the late 1960's.
Schnitzer had been involved in developing and managing high-rise office buildings through Century Development Co., Inc. (Century Development), a subsidiary of Century, Inc. (Century), Schnitzer's family holding company.
The real estate development business, however, typically was cyclical. In 1974, to diversify its operations and to secure a steady source of earnings, a subsidiary of Century acquired for $1.3 million the assets of a small real estate management company called Fletcher Emerson Co., Inc. (Fletcher Emerson). [FN13] Fletcher Emerson managed office buildings and other commercial real estate. A relatively small portion of its business included cleaning or janitorial services on some Texas commercial properties it managed. Shortly after Century's subsidiary acquired the assets of

Fletcher Emerson, the subsidiary's name was changed to Fletcher Emerson Co. and then to Property Management Systems, Inc. For convenience Property Management Systems, Inc., is hereinafter referred to as Schnitzer-PMS. Schnitzer became the chairman and chief executive officer of Schnitzer-PMS.

Originally, Schnitzer-PMS's property management business was conducted primarily in Houston and Dallas, Texas. Schnitzer-PMS usually managed office buildings and other commercial real estate owned by others under property management contracts on a month-to-month basis. Schnitzer wanted to expand the size of Schnitzer-PMS's property management business, as Schnitzer-PMS typically earned only a relatively modest profit margin on its individual property management contracts. Schnitzer felt that the only way to increase Schnitzer-PMS's profits was having a large volume of such management contracts.

Fletcher Emerson had been managing a relatively small number of Prudential's commercial real properties when Century acquired its assets in 1974. Schnitzer wanted to develop business from Prudential and American Building Maintenance Industries (AMBI). To that end, Schnitzer offered AMBI the opportunity to acquire 50 percent of the company. AMBI, however, declined the offer.

In 1974, Schnitzer approached Ballard (who Schnitzer had known for many years and previously had dealt with in developing office buildings in Houston, Texas) and offered to have Century give Prudential a 50-percent stock interest in Schnitzer-PMS. Although Prudential would not be required to pay for the 50- percent Schnitzer-PMS stock interest, Schnitzer hoped Prudential would award Schnitzer-PMS a large number of additional property management contracts. Ballard informed his superiors at Prudential of Schnitzer's offer.

Initially, Prudential was interested in Schnitzer's offer and invited Schnitzer to Prudential's Newark, New Jersey, corporate headquarters for further meetings and discussions

with Prudential's management. Schnitzer met with Prudential's senior executives and corporate headquarters staff, including Prudential's chairman, and with Knab (who headed Prudential's real estate department). Prudential was particularly interested in standardizing the reports it received on the operation of its various commercial real properties around the country. However, Prudential ultimately declined Schnitzer's offer because of the substantial number of pension plans whose real estate investment accounts Prudential managed. Prudential believed that having an ownership interest in Schnitzer-PMS might be a potential conflict of interest and might present problems under the pension laws.

Ballard introduced Schnitzer to Kanter sometime between the early and mid- 1970's. At some time prior to September 1976, Schnitzer and Kanter began discussing the sale of a stock interest in Schnitzer-PMS to Kanter. Kanter indicated that, through his business contacts, including the Pritzker family, he could obtain additional property management business for Schnitzer-PMS. Before Schnitzer made the offer to Kanter, Schnitzer had a conversation with Ballard to confirm that Kanter could bring in business for Schnitzer-PMS.

The initial proposal contemplated that Schnitzer-PMS would be recapitalized in order to provide for the issuance of two classes of stock, common and preferred. The preferred stock would be $1,000 par value per share, one vote per share, priority as to dividends, when, if, and as declared out of available earnings and profits up to a maximum of 8 percent of the par value in the year of declaration, and priority on liquidation. The common stock would be no par common stock carrying one vote per share. Kanter's client (IRA) would purchase 50 percent of the common stock for $50,000 and closing would be set for October 1, 1976.

Because of difficulties in finalizing the agreement, however, closing did not take place in 1976. In a letter dated April 12, 1977, to Melvin Dow, Kanter stated:

As you know, the president of The Cedilla Company is Mildred D. Schott and The Cedilla Company is actively engaged in certain phases of real estate activity. We are hopeful that the sooner the acquisition of * * * [Schnitzer-PMS] shares can be closed, the sooner that serious efforts can begin to create that synergism that could result in a sharply expanded business for * * * [Schnitzer-PMS] in its property management through the extensive contacts Schott maintains, the broad scope of opportunity that may be available to Solomon A. Weisgal and the opportunities that may arise in the course of my practice which involves representation of numerous very wealthy groups holding large property interests.

By letter agreement dated November 7, 1977, Kanter and Schnitzer agreed that Schnitzer-PMS would be recapitalized and reorganized as a Delaware corporation with an authorized capitalization of 250 voting preferred shares of $1,000 par value each and 108 voting common shares of $1 par value each. Each preferred share would be entitled to a cumulative preferred dividend of $80 per year, plus a special one-time dividend equal to 1/250 of the indebtedness of Schnitzer-PMS to American General Investment Corp. existing at the time the special dividend was declared. The special dividend was to be declared when the assets of the corporation available for payment of dividends equaled the remaining amount outstanding on the loan. At the time of the reorganization, $1.1 million that Century Development had borrowed to purchase Fletcher Emerson was still owing. The purpose of the special dividend was to permit Century Development to recover its initial investment. Kanter's client (IRA) had the option to purchase 51.3 shares of common stock (47.5 percent of the common stock) in Schnitzer-PMS for $150,000.

The reorganization was completed on January 31, 1978, and 51.3 shares of the common stock of Schnitzer-PMS were issued to IRA on February 14, 1978. All shares of Schnitzer-PMS (including those issued to IRA) were pledged to secure

Century Development's loan balance.

In conjunction with the sale of the Schnitzer-PMS stock to IRA, IRA and Century entered into a stock agreement. Article III of the agreement gave Century an option to purchase the Schnitzer-PMS stock upon the death of last to die of Kanter, Weisgal, and Schott. Section 3.03 of the stock agreement provided that the purchase price for IRA's shares of Schnitzer-PMS stock would be an amount equal to the sum of:

(a) Eight (8) times the average annual pretax operating income of the Corporation for the five (5) full fiscal years of the Corporation ending on or immediately preceding the Option Date or such lesser number of full years of operation of the Corporation as shall have expired from the date of this Agreement; plus

(b) The difference (but not less than zero) between (i) the book value of the assets of the Corporation used in its business of building management, consulting and cleaning and (ii) the lesser of Three Hundred Thousand Dollars ($300,000) or one and one-half (1-1/2) times the Corporation's average receipts for one (1) month, computed for the twelve (12) month period immediately preceding the Option Date; plus

(C) The fair market value of any other assets of the Corporation.

The computation of operating income in Subsection (a) hereof shall be computed solely with reference to the Corporation's business of building management, consulting and cleaning. The computation of the purchase price shall be made by the certified public accountants regularly retained by the Corporation.

By late 1977, Schnitzer-PMS's property management business had increased substantially. Although Prudential had declined Schnitzer's offer to give Prudential an interest in Schnitzer-PMS, Prudential became Schnitzer-PMS's biggest customer. Pursuant to Schnitzer's discussions with Prudential's management and corporate headquarters staff

in 1974, Schnitzer-PMS standardized its reports on the Prudential commercial real properties that Schnitzer-PMS managed. By 1977, Schnitzer-PMS had expanded its property management operations to other cities around the country, including Atlanta, Georgia, Los Angeles and San Francisco, California, Newark, New Jersey, and Portland, Oregon.
Schnitzer-PMS year-end balance sheets and profit/loss statements for 1976 through 1978 showed the following:

Assets	1976	1977	1978
Current	$529,225	$527,025	$690,257
Property	97,913	127,645	133,970
Other	8,142	36,542	137,459
Total	635,280	691,212	961,686
Liabilities			
Current	287,829	156,947	237,681
Long-term	6,515	21,647	33,935
Stockholder equity			
Common	1,000	1,000	108
Preferred	n/a	n/a	250,000
Contributed capital	200,000	200,000	n/a
Retained earnings	139,936	311,618	439,962
Total	635,280	691,212	961,686
Earnings			
Revenues			
Property management	1,044,173	1,448,101	--
Cleaning	2,343,512	2,811,034	--
Other	39,411	41,352	--
Total	3,427,096	4,300,487	5,977,383
Costs & expenses			

Property management	255,824	266,794	4,064,014
Cleaning	1,986,343	2,483,019	
General	864,715	1,095,499	1,078,503
Interest	2,599	4,117	3,037
Total	3,109,481	3,849,429	5,145,555
Pretax earnings	317,615	451,058	831,828
Tax allocation	143,163	155,527	--
Net earnings	174,452	295,531	--

By March 1979, Schnitzer had decided that Schnitzer-PMS should have received more opportunities for new business from Kanter and his associates and informed Kanter that he wanted to repurchase the stock held by IRA. Kanter and Schnitzer decided that one party would set a price at which that party was willing to either sell its stock to the other or buy the other's stock. By letter dated July 17, 1979, Kanter informed Schnitzer that IRA would sell its stock in Schnitzer-PMS or purchase Century Development Corp.'s stock in Schnitzer-PMS for $3.1 million. Schnitzer agreed to buy back IRA's stock for $3.1 million. On November 30, 1979, Century repurchased the 47.5-percent owned by IRA in July 1979, for $3.1 million, payable over a 10-year period with interest. At the time of the repurchase, approximately $700,000 remained outstanding on the loan from the original purchase of the Fletcher Emerson assets.
Schnitzer-PMS balance sheets and profit/loss statements for 6 months ending June 30, 1978 and June 30, 1979 showed the following:

	6/30/78	6/30/79
Assets		
Cash	$124,632.16	$284,760.00

Life insurance 41,968.71 96,144.81
Accounts receivable 555,308.63 496,200.83
Supplies 3,450.04 14,614.58
Prepaid expenses 13,877.99 45,007.01
Transportation equipment 14,101.56 17,268.74
Other equipment 116,190.70 130,547.74
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Total 869,529.79 1,084,543.71

Liabilities

Accounts payable 6,569.23 --
Accrued payroll expense 97,763.69 134,094.52
Other accrued expenses 109,892.85 121,486.51
---------- ----------
Total 214,225.77 255,581.03

Stockholder's equity

Capital stock 250,108.00 250,108.00
Retained earnings 384,885.60 1,198,788.79
Funds to CDC (431,036.94) (955,412.90)
1977 net income 451,347.36 n/a
1978 net income n/a 335,478.79
---------- ----------
Total owner's equity 655,304.02 828,962.68

Total liabilities & equity 869,529.79 1,084,543.71

Profit/Loss (6 months) 2,916,478.65 3,650,217.86
Gross income 1,824,034.25 2,485,250.27
---------- ----------
Operating expenses 1,092,444.40 1,164,967.59
Operating income 542,291.04 740,191.69
---------- ----------
Overhead expense 550,153.36 424,775.90

Income before acquisition 98,806.00 89,178.98
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Acquisition expense 451,347.36 335,596.92
Net income

Around the end of 1979 or early 1980, Schnitzer discussed the sale of Schnitzer-PMS to Minneapolis Honeywell for a price between $12 million and $13 million. Honeywell, however, decided not to purchase Schnitzer-PMS.
In 1989, IRA accepted a reduced final payment for early payment of the balance due on the sale of the stock.
IRA received the following payments of principal and interest and reported the following gain on the installment sale of the Schnitzer-PMS stock:

Year Payment Principal Interest Gain
------ -------- -------- -------- --------
1979 $150,000 $150,000 -- $142,740
1980 533,425 211,468 $321,957 201,233
1981 534,696 309,308 225,388 294,338
1982 361,692 172,441 189,251 164,094
1983 361,692 186,655 175,037 177,621
1984 361,692 202,042 159,650 192,263
1985 361,692 218,696 142,996 208,111
1986 361,692 236,724 124,968 225,266
1987 361,692 256,217 105,475 243,816
1988 361,692 277,360 84,332 263,936
1989 840,423 822,841 17,582 783,016
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Total 4,590,388 3,043,752 1,546,636 2,896,434

E. The Eulich Arrangement: Essex Hotel Management Co.
1. Eulich's Background
For many years, Eulich had been a real estate developer of office buildings, shopping malls, and warehouses in Houston and Dallas, Texas. Eulich had known Ballard and Lisle since at least 1965. Eulich dealt with Ballard and Lisle

in connection with Prudential's financing his real estate development work, when Ballard and Lisle worked in Prudential's Houston regional office. [FN14] Eulich was also a close personal friend of A.N. Pritzker. Eulich met Kanter through Pritzker in the late 1960's or early 1970's. Kanter and Eulich had many business dealings with each other. Kanter helped raise capital for some of Eulich's business ventures. Eulich's real estate development activities were primarily conducted through Vantage, Inc., a corporation that he owned. In 1968, Eulich acquired Rodeway Inns, a company that owned a small chain of garden court motels. Over the years, Rodeway Inns increased the number of its motels. Rodeway Inns and Eulich obtained financing from Prudential for the acquisition of many of the additional motels. From 1968 through about 1973, Eulich dealt with Ballard in securing the financing from Prudential for Rodeway Inns.

In about 1974, Eulich and Prudential became dissatisfied with the performance of the hotel management company that was managing and operating 16 Rodeway Inns motels that had been financed by Prudential. Eulich decided to establish his own hotel management company, Motor Hotel Management, Inc. (Eulich-Management), to operate the motels. Eulich-Management was incorporated on January 1, 1975.

Eulich asked Robert James (James) who had substantial hotel management experience, to serve as Eulich-Management's president and to manage Eulich- Management's day-to-day operations. Eulich-Management's three shareholders eventually included Eulich (who was the majority shareholder), James, and another longtime business associate of Eulich.

By the end of 1975, Eulich-Management had 17 management contracts that were part of the joint venture in which Prudential was the lender and Eulich's company Vantage, Inc., was the developer. By the late 1970's, Eulich-Management had a good reputation in providing hotel

management services. Prudential's real estate department staff generally was satisfied with Eulich-Management's management of a number of hotel properties in which Prudential was involved. By about the early 1980's, Eulich-Management managed hotel properties nationwide in about 20 to 25 States. At that time, however, Eulich-Management did not manage large hotels.

2. Prudential's Gateway Hotel

In about 1976, Ballard decided that Prudential's real estate department needed to hire an individual possessing substantial expertise in hotels and hotel operations. Allen Ostroff (Ostroff) had worked for a number of years for Hilton Hotels as a hotel manager and executive. Ballard hired Ostroff to serve as Prudential's in-house consultant on hotels and hotel operations.

When Ostroff began working for Prudential, the real estate department staff in Prudential's regional offices negotiated hotel management contracts for Prudential's hotel properties on an ad hoc basis. By 1979, Ostroff had devised a model hotel management contract that Prudential's real estate department staff could use in negotiating such management contracts. Ostroff also worked on various hotel projects with Knab, Ballard, and Lisle.

One of Ostroff's first assignments at Prudential was to improve the operating condition of the Gateway Hotel located a few blocks from Prudential's corporate headquarters in Newark, New Jersey. Prudential had recently acquired the Gateway Hotel through foreclosure, and the hotel was in shabby condition. Moreover, Prudential wanted to upgrade the hotel because Prudential executives and individuals transacting business at Prudential's headquarters office frequently stayed at the hotel.

Ostroff first obtained a Hilton franchise for the Gateway Hotel. [FN15] Ostroff next hired a new hotel management company to take over the Gateway Hotel's management and operation. The new management company was owned by Stanley Cox (Cox), an experienced hotel manager Ostroff

had known during Ostroff's prior employment with Hilton Hotels. At some point, Cox assigned John Connolly (Connolly) to be the Gateway Hotel's on-site manager. Ostroff was extremely successful in turning around and substantially improving the Gateway Hotel's operating condition. Prudential executives made significant use of the hotel facilities for meetings and entertainment and were very pleased with the service that they and their guests received at the hotel.

Cox did not spend much of his own time in actually running the Gateway Hotel. Over the years, he had delegated more and more duties in the hotel's operation to Connolly. Connolly frequently interacted with Prudential executives, including Ballard and Lisle. Sometime in 1978 or 1979, Connolly met Kanter at the Gateway Hotel.

In 1981, Connolly informed Ostroff that he was considering leaving his position as on-site manager of the Gateway Hotel, because he felt he was not being adequately compensated for his services. Ostroff attempted unsuccessfully to have Cox increase Connolly's pay. Ostroff and his superiors at Prudential, including Ballard, decided to terminate Prudential's management contract with Cox and to award the management contract to Connolly.

Ostroff told Connolly that Prudential wanted him to manage the Gateway Hotel. Ostroff informed Connolly that he would have to establish a management company of his own and that all hotel employees would have to be employees of Connolly's hotel management company. [FN16] Establishing such a hotel management company, however, presented a problem for Connolly. The management company would be required, among other things, to employ a financial manager and an accounting staff to prepare and issue the financial reports required by Prudential on the Gateway Hotel's operations. The full-time employment of such personnel to perform these and other required services could well be uneconomical, since Connolly's company would be managing only one or two hotels.

Ballard introduced Connolly to Eulich. Eulich also knew Kanter from certain prior business ventures in which Kanter had helped raise capital. Kanter and Eulich were aware Connolly would need assistance for his hotel management company. Eulich also wanted Eulich-Management's business to include the management of a number of large hotels. He believed that Kanter's business contacts, including contacts with the Pritzker family, could be beneficial to Eulich-Management.

Eulich, Kanter, and Connolly decided to organize several entities to further their objectives. A hotel management company called Gateway Hotel Management Corp. (Gateway Corp.) was incorporated in 1981. Another corporation, Essex Hotel Management Co. (Essex Corp.), was also formed.

A letter from Eulich to Connolly dated October 16, 1981, indicated that Eulich provided $10,000 for the initial capitalization of Gateway Corp. The letter also indicated that initially Essex Corp. owned 80 shares (80 percent) of the Gateway Corp. stock, that Connolly owned 20 shares (20 percent), and that Connolly had an option to purchase Essex Corp.'s 80 shares. [FN17]

By March 2, 1982, however, Connolly owned 100 shares (100 percent) of the Gateway Corp. stock. A stock option agreement "made and entered into" September 18, 1981, but "executed as of" March 2, 1982, recites that Connolly owned 100 shares of $1 par value common stock of Gateway Corp. Under the stock option agreement, Connolly granted Essex Corp. a 10-year option to purchase 80 shares of the common stock of Gateway Corp. for $100 per share. [FN18] In consideration for the option, Essex Corp. agreed to pay Connolly $1,000 per year for the term of the option.

Eulich, Kanter, and Connolly also formed a partnership called Essex Hotel Management Co. (the Essex partnership or Essex), which was organized effective January 1, 1982. The partners of Essex and their partnership interests were as follows:

Partner	Partnership Interest
Eulich-Management	47.500
IRA	26.125
Holding Co.	21.375
Connolly	5.000

Although the Essex partnership agreement required its partners to contribute any capital needed to operate the partnership, very little, if any, actual capital contributions were ever required from them. The Essex partnership had no office, equipment, or employees.

In late 1981, Gateway Corp. entered into a management contract with Prudential to operate the Gateway Hotel and entered into a second management contract effective February 1, 1982, to operate another Hilton-franchised hotel that Prudential owned at Midland, Texas (the Midland Hotel). [FN19]

The Essex partnership entered into "Representation and Marketing" agreements with Eulich-Management and Gateway Corp., also effective January 1, 1982. [FN20] At the time, Eulich-Management managed the Allentown Hilton and the Madison Hotel. Although both were owned by third parties, Prudential had helped finance the construction of the two hotels. Essex's agreement with Eulich- Management (the Eulich-Management/Essex agreement) required Eulich-Management to pay to Essex 30 percent of its management fees from the operation of the Madison Hotel and 43 percent of the fees from the operation of the Allentown Hilton. The agreement with Gateway Corp. (the Gateway Corp./Essex agreement) required Gateway Corp. to pay to Essex 75 percent of Gateway Corp.'s management fees from the operations of the Gateway Hotel and the Midland Hotel. Employees of Eulich-Management performed record-keeping and reporting services for Gateway Corp. A number of Eulich-Management's personnel were instructed to do

whatever they could to help Connolly with Gateway Corp.'s operations. For instance, Eulich-Management employees helped perform the financial and accounting services that Gateway Corp. required in connection with its Gateway and Midland hotel management contracts. In yet another instance, a Eulich- Management employee helped Connolly with union negotiations. Also, after Prudential awarded the Midland, Texas, hotel's management contract to Gateway Corp., Eulich-Management's employees helped Connolly find an on-site manager for that hotel. Eulich-Management did not charge Gateway Corp. for these services. IRA and Holding Co., in contrast to Eulich-Management, provided no services to Gateway Corp.

The Essex partners agreed that Gateway Corp. and Eulich-Management generally would pay the same fees to the Essex partnership. The partnership's specified percentage of fees under each consulting and fee participation agreement could easily be adjusted and modified, as each consulting and participation agreement was cancelable by a 30- to 90-day notice. As a result, if a significant change occurred with respect to the compensation that Gateway Corp. or Eulich-Management received under a particular hotel management contract, an offsetting change then could be effectuated in the other consulting and fee participation agreements Gateway Corp. and Eulich Management had with Essex.

In late 1983, Eulich-Management received a hotel management contract for Prudential's Hilton-franchised Twin Sixties Hotel at Dallas, Texas. A new Eulich-Management/Essex agreement was made effective January 1, 1984, whereby Eulich-Management agreed to pay to Essex 70 percent of the fees from the Madison Hotel, 57 percent of the fees from Allentown Hilton, and 57 percent of the fees from Twin Sixties. [FN21]

Effective January 1, 1986, a new Gateway Corp./Essex agreement reduced Essex's share of Gateway Corp.'s fees from the operations of the Gateway Hotel and the Midland Hotel from 75 percent to 40 percent.

Although Eulich-Management was sold by Eulich to an unrelated company called Aircoa in 1986, Eulich-Management continued to participate as a partner in Essex until about 1990.
In early 1990, Gateway Corp. lost the management contracts on the Gateway and Midland hotels and ceased operating. The Essex partnership terminated by 1991.
During the years 1982 through 1988, Essex reported the following amounts as received and/or accrued [FN22] commission fee payments from Gateway Corp. and Eulich-Management:

Year	Gateway	Eulich-Mgt.
1982	$234,170	$104,121
1983	222,557	235,718
1984	268,663	242,116
1985	225,487	230,847
1986	68,000	123,089
1987	172,963	388,632
1988	142,761	238,889
Total	1,334,601	1,563,412

For the 1989 taxable year, Essex reported $293,261 in total income from consulting fees from Eulich-Management and Gateway Corp.
For the taxable years 1982 through 1989, Essex made distributions to IRA, Holding Co., Connolly, and Eulich-Management in the following amounts:

Year	IRA	Holding	Connolly	Eulich-Mgt.
1982	$86,212	$70,538	$16,500	$156,750
1983	78,375	64,125	15,000	142,500
1984	133,238	109,013	25,499	242,250
1985	120,175	98,325	23,000	218,500

1986	80,465	65,835	15,400	146,300
1987	120,698	98,752	23,100	219,450
1988	117,562	96,118	22,500	213,750
1989	51,727	42,322	9,900	94,051
Total	788,452	645,028	150,899	1,433,551

The distributions to all partners from 1982 through 1989 totaled $3,017,930.
The following diagram illustrates the Essex arrangement:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
F. Diagram: Summary of Payments From the Five 1977 Through 1989
The following diagram shows the money paid by the Five to IRA, Zeus, KWJ Corp. and Holding Co. from 1977 through 1989:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Most of the payments made by the Five were attributable to Ballard's and Lisle's influence in awarding contracts with Prudential (the Prudential transactions), some were attributable to Lisle's influence in awarding contracts with Travelers (the Travelers transactions), and some were attributable to Kanter's influence in transactions that did not necessarily involve Prudential or Travelers (the Kanter transactions).
G. Changes in IRA and Subsidiaries Corporate Structure From 1974 Through 1988
IRA's predecessor, Cedilla Co., was incorporated in 1974. Keating acquired 1,000 shares of the common stock, and Schott acquired 1,000 shares of its preferred class A stock. In 1975, Weaver agreed to sell KWJ Corp. to Kanter's "client". In 1975, Keating's common stock was exchanged for 500 shares of class B preferred stock, and Weisgal as trustee of the Bea Ritch trusts acquired 1,000 shares of the common stock. The Cedilla Co's.1975 balance sheet at the end of 1975 reflected

the following:

Assets
Cash $564
Loans receivable 21,100
Prepaid expenses 89

Total 21,753
Liabilities 5,000

Net assets 16,753

Capital stock
Preferred 1,050
Common 100
Capital surplus 50
Retained earnings 15,553

The following series of diagrams illustrates the changes in the IRA organizations during the years at issue to accommodate the various transactions.
1976-77
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Cedilla Co. acquired Cedilla Investment Co. (engaged in equipment leasing transactions) in December 1976. During 1976 Kanter negotiated IRA's purchase of KWJ Corp. from Weaver and began discussing the purchase of Schnitzer-PMS from Schnitzer. In 1977 Keating's preferred stock was redeemed.
IRA's consolidated returns for 1976 and 1977 reported consolidated net losses [FN23] of $7,954 in 1976 and $271,394 in 1977, a net loss for Cedilla Investment Co. of $174,003 in 1976 and $345,950 in 1977, and reflected the following income and end-of-year balance sheets with respect to IRA (unconsolidated):

	1976	1977
Income		
Gross receipts	$640,000	$112,982
Dividends	--	9,217
Interest	9,525	9,409
Partnership	(260,934)	5,214
Total	388,591	136,822
Deductions		
Compensation/officers	--	19,300
Salaries/wages	--	986
Commissions	213,333	12,000
Other	9,209	22,866
Total	222,542	55,152
Net Income	166,049	81,670
Special deductions		(7,114)
Taxable Income	166,049	74,556
Assets		
Cash	301,401	134,270
Loans receivable	40,000	370,500
Securities		
Marketable	15,663	290,213
Non-marketable	--	65,000
Investment in sub.	15,000	15,000
Investment in pship	(185,834)	(180,620)
Cedilla trust	--	5,000
Other	361	2,213
Total	186,591	701,576
Liabilities		
Payables	--	2,000
Short term	--	65,000

Long term -- 370,000
Other 6,900 3,182
--------- ---------
Total 6,900 440,182
Net assets 179,691 261,394
Capital stock
Preferred 1,050 1,000
Common 100 100
Capital surplus 50
Retained earnings 178,491 260,344
Cost of treasury stock -- (50)

1978
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
In January 1978, IRA purchased the Schnitzer PMS stock. In 1978, Cedilla Co. changed its name to Investment Research Associates, Ltd. (IRA). In April 1978, IRA acquired 1,000 shares (100 percent) of the voting stock of Arba Investments, Inc., and changed Arba's name to Cedilla Co.
IRA's consolidated return for 1978 reported consolidated net losses of $18,673 and a net loss for Cedilla Investment Co. of $605,992 and reflects the following income and end-of-year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

IRA Cedilla Co.
--------- ---------
Income
Gross receipts $777,499 $10,697
Dividends 20,572 --
Interest 38,885 18
Capital gain 69,715 --
Partnership 4,829 --
--------- ---------
Total 911,500 10,715
Deductions

Compensation--officers 15,000 7,500
Salaries/wages 5,051 4,287
Consulting Fees 51,900 --
Commissions 207,237 --
Other 18,565 8,446
--------- ---------
Total 297,753 20,233
Net income 613,747 (9,518)
Special deductions (16,910) --
--------- ---------
Taxable income 596,837 (9,518)

Assets
Cash 28,600 70,996
Loans
Stockholders 287,900 --
Others 734,350 6,385
Securities
Marketable 318,197 --
Nonmarketable 215,000 --
Investment in sub. 34,024 --
Investment in pship. (180,703) --
Cedilla trust 4,511 --
Other 1,051 2,060
--------- ---------
Total 1,442,930 79,441
Liabilities
Payables 70,000
Short term 197,575 --
Long term 370,000 --
Other 1,211 555
--------- ---------
Total 568,786 70,555
Net assets 874,144 8,886
Capital stock
Preferred 1,000 --
Common 100 1,000

Capital surplus 18,024
Retained earnings 873,094 (10,138)
Cost of treasury stock (50)

1979
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Although IRA acquired 100 shares (100 percent) of KWJ Corp. in November 1978, IRA first included KWJ Corp. on its 1979 consolidated return. [FN24] During 1979, IRA sold its Schnitzer-PMS stock back to Century Development. Schaffel's payments to IRA began in 1979. Frey's arrangement began in 1979 and, in December 1979, IRA acquired 1,000 shares of Zeus Ventures, Inc. (Zeus).
IRA's consolidated return for 1979 reported a consolidated net loss of $20,728, a net loss for Cedilla Investment Co. of $320,425, and net taxable income from KWJ Corp. of $119,646 and reflects the following income and end-of- year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

IRA Cedilla Co.
--- ---
Income
Gross receipts $73,280 $101,274
Dividends 3,125 --
Interest 112,804 1,038
Gross rents 225 --
Capital gain 141,519 --
Partnership 1,157,861 --
Management fees -- 2,750
Consulting fees 100,000
--- ---
Total 1,588,814 105,062
Deductions
Compensation--officers -- 26,800
Salaries/wages -- 4,100

Depreciation 638,550 --
Consulting fees 125,000 --
Commissions 209,440 --
Other 60,911 19,470
--- ---
Total 1,033,901 50,370
Net income 554,913 54,692
Special deductions (2,055) --
--- ---
Taxable income 542,858 54,692

Assets
Cash 962,964 11,806
Loans
Stockholders 1,200 --
Others 3,725,675 21,885
Treasury bills -- 24,308
Securities -- --
Marketable 177,951 --
Nonmarketable 65,000 --
Investment in sub. 234,024 --
Investment in pship. 130,907 1,800
Depreciable assets 5,108,573 --
Less accumulated dep. (638,550) --
Cedilla trust 4,511 --
Deferred expenses 91,640 --
Other 1,029 2,060
--- ---
Total 9,864,924 61,859
Liabilities
Payables
Short term 309,795 --
Long term 5,319,924 --
Deferred income 2,807,260 --

Total 8,436,979 --
Net assets 1,427,945 61,859

Capital stock
Preferred 1,000 --
Common 100 1,000
Capital surplus -- 18,024
Retained earnings 1,426,895 42,835
Cost of treasury stock (50) --

1980
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
In January 1980, IRA acquired 1,000 shares (100 percent) of Brickell Enterprises, Inc. (Brickell).
IRA's consolidated return for 1980 reported consolidated taxable income of $65,094, a net loss for Cedilla Investment Co. of $145,887, net taxable income for Zeus of $118,269, a net loss for KWJ Corp. of $2,620, and net taxable income from Brickell of $90,225 and reflects the following income and end-of- year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

IRA Cedilla Co.
--- ---
Income
Dividends $15,467 --
Interest 578,031 $2,373
Gross rents 581,180 300
Capital gain 217,981 --
Partnerships 1,448,542 --
Commissions & fees 244,920 38,311
--- ---
Total 3,086,121 40,984
Deductions
Compensation--officers -- 19,800
Salaries/wages -- 6,918
Interest 916,507 --
Depreciation 2,115,376 2,294
Commissions/fees -- --

Other 14,226 33,705
--- ---
Total 3,046,109 62,717
Net income 40,012 (21,733)
Special deductions (13,147) --
--- ---
Taxable income 26,865 (21,733)

Assets
Cash 1,399,085 1,510
Trade receivables 703 --
Loans
Stockholders 1,200 --
Others 1,896,320 15,885
Installment receivable 2,738,532 --
Securities
Marketable 411,481 --
Nonmarketable 348,024 --
Investment in sub. -- --
Investment in pship. 326,072 --
Depreciable assets 12,468,476 22,937
Less accumulated dep. (2,753,926) (2,294)
Cedilla trust 4,511 --
Deferred expenses 91,640 --
Other 1,325 2,060
--- ---
Total 16,933,443 40,098
Liabilities
Payables 118,756 --
Short term 606,000 --
Long term 12,258,949 --
Deferred gain 2,606,029 --
Other 2,869 --

Total 15,592,603 --
Net assets 1,340,840 40,098
Capital stock

Preferred 1,000 --
Common 100 1,000
Capital surplus 18,024
Retained earnings 1,339,740 21,074

1981-82
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
During 1981, Essex Corp. and Gateway Corp. were organized. In November 1981, IRA acquired 1,000 shares of IRA Florida Apartments, Inc. (IRA Flor. Apts.). During 1982, the Essex partnership was organized. During 1982, Ballard and Lisle retired from Prudential; Lisle began employment with Travelers, and Ballard began employment with Goldman-Sachs.
IRA's consolidated returns for 1981 and 1982 reported consolidated net losses of $615,852 and $121,501, respectively, which included a net loss of $25,057 in 1981 and net taxable income of $72,407 for Cedilla Investment Co., net income of $107,887 in 1981 and $448,691 in 1982 for Zeus, net income of $91,118 in 1981 and $155,842 in 1982 for KWJ Corp., net income of $5,954 in 1981 and a net loss of $19,184 in 1982 from Brickell, and net losses of $6,568 in 1982 from IRA Florida Apts. and reflects the following income and end-of-year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

1981		1982	
IRA	Cedilla Co.	IRA	Cedilla Co.
Income			
Dividends	$2,306	--	$333,611	--
Interest	673,674	1,747	354,531	7,587
Gross rents	2,484,330	8,550	2,437,715	4,828
Capital gain	304,883	--	--	--
Partnerships	725,964	--	(483,219)	--

Commissions	205,275	62,585	325,000	112,958
Parking income	--	823	--	--
Management fees	--	2,375	5,832	--
Other fees	156,250	--	447,450	--
Miscellaneous	91	--	1,514	478
Total	4,552,773	76,080	3,422,434	125,851
Deductions				
Compensation--officers	--	26,300	--	--
Directors fees	12,500	--	--	--
Salaries/wages	9,969	9,361	26,079	9,231
Bad debts	395,600	--	162,200	--
Interest	2,164,579	--	1,872,881	32
Depreciation	2,561,361	5,047	1,610,457	5,047
Consulting fees	--	--	29,000	--
Commissions	115,400	--	--	66,776
Other	85,284	30,678	58,580	34,764
Total	5,344,693	71,386	3,759,197	115,850
Net Income	(791,920)	4,694	(336,763)	10,001
NOL	--	--	(793,880)	--
Special deductions	(1,960)	--	(322,569)	--
Taxable income	(793,880)	4,694	(1,453,212)	10,001
Assets				
Cash	28,671	1,885	57,110	104
Money market	107,379	8,684	43,885	14,065
Receivables				
Notes & accounts	2,429,224	--	2,256,783	--
Rents	3,570	--	--	--
Loans				
Stockholders	366,350	--	340,930	--
Others	3,066,284	26,860	3,002,131	37,600
Securities				
Short term	1,030,000	--	1,460,000	--
Marketable	405,293	--	492,663	--

Nonmarketable 200,700 -- 312,700 --
Investment in sub. 236,024 -- 268,924 --
Investment in pship. 2,607,473 -- 2,149,204 --
Depreciable assets 12,478,152 24,550 10,270,651 24,550
Less accumulated dep. (5,315,286) (7,341) (6,000,765) (12,388)
Other -- 447 1,190 1,380
---------- ---------- ---------- ----------
Total 17,643,834 55,085 14,655,406 65,311
Liabilities
Short term notes 585,000 9,600 1,038,099 9,600
Long term notes 13,754,966 -- 11,259,516 --
Loan from stockholder 262,400 -- 2,400 --
Deferred gain 2,311,689 -- 2,147,594 --
Other -- 693 914 981
---------- ---------- ---------- ----------
Total 16,914,055 10,293 14,448,523 10,581
Net assets 729,779 44,792 206,883 54,730
Capital stock
Preferred 1,000 -- 1,000 --
Common 100 1,000 100 1,000
Capital surplus -- 18,024 -- 18,024
Retained earnings 728,679 25,768 205,783 35,706

1983
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
IRA reported that it liquidated Brickell, IRA Florida Apts., and KWJ Corp. under section 332 during 1983. In December 1983, IRA acquired 1,000 shares (100 percent) of the common stock of Carlco, TMT, and BWK, Inc.
IRA's 1983 consolidated return and adjusting journal entries show that Schott's shares of IRA preferred stock were redeemed in 1983 in exchange for IRA's 1,000 shares of Cedilla Co. common stock. IRA reported that its shares of Cedilla Co. were redeemed for $1,000 in April 1983 and reported a long-term capital loss of $18,024 on the sale. IRA's consolidated income also included a $35,000 net operating

loss from Cedilla Co. Cedilla Co. had no income and claimed a deduction of $35,000 for commission expenses. Cedilla Co.'s 1983 adjusting journal entry indicates that the $35,000 due to Schott was paid by offsetting amounts owed by Schott to Cedilla Co.
IRA's consolidated return for 1983 reported a consolidated net loss of $425,538, net income of $140,065 for Cedilla Investment Co., net income of $149,128 for Zeus, net income of $139,783 for KWJ Corp ., a net loss of $21,567 from Brickell, and a net loss of $18,356 from IRA Florida Apts. and reflects the following income and end-of-year balance sheets with respect to IRA (unconsolidated):

IRA

Income
Dividends $343,080
Interest 402,022
Gross rents 2,581,652
Capital gain 314,855
Partnerships (689,461)
Commissions
General fees 244,732
Consulting fees 26,000

Total 3,222,880
Deductions
Bad debts 22,075
Interest 1,834,892
Depreciation 1,636,137
Commissions/fees
Other 88,311

Total 3,581,415
Net Income (358,535)
NOL (1,453,212)
Special deductions (336,303)

Taxable Income (2,148,050)
Assets
Cash 110,281
Pooled funds 38,250
Notes Receivable 2,070,128
Loans
Stockholders 292,260
Others 1,592,983
Securities
Short term 3,776,000
Marketable 564,827
Nonmarketable 192,700
Investment in sub. 83,000
Investment in pship. 1,640,284
Depreciable assets 11,286,020
Less accumulated dep. (7,636,902)
Other 2,365

Total 14,012,196
Liabilities
Payables
Short term 1,341,617
Long term 11,060,633
Deferred gain 1,969,973
Other ----------
Total 14,372,223
Net assets (360,027)
Capital stock
Preferred
Common 100
Capital surplus
Retained earnings (360,127)

1984-87
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT
IS NOT DISPLAYABLE

IRA distributed cash accumulated from Prudential transactions, including cash received from Zeus and the liquidation of KWJ Corp. and its interests in the Essex and Sherwood partnerships, in the ratio of 45 percent each to Carlco and TMT and 10 percent to BWK, Inc. Carlco, TMT, and BWK, Inc., contributed the Hyatt contract rights to a new partnership called KWJ Co.
IRA's consolidated returns for 1984 to 1987 reported the following consolidated net losses, net income or loss for Cedilla Investment Co. and Zeus, and income for IRA, and reflect the following end-of-year balance sheets with respect to IRA (unconsolidated):

1984 1985 1986 1987
--- --- --- ---
Consolidated
income (loss) ($175,946) $96,363 ($327,854) ($16,942)
Cedilla Invest. 331,263 376,929 (1,148,003) (704,460)
Zeus (96,473) (153,108) (151,122) (181,747)
IRA
Income
Dividends 113,505 97,206 87,079 31,960
Interest 247,230 177,236 164,843 238,396
Gross rents 2,689,177 2,689,177 1,175,346 1,271
Capital gain 247,929 -- (62,833) 604,750
Partnerships 24,821 (202,702) 373,779 186,845
Loss notes -- -- -- (1,176,670)
Commissions/fees -- -- -- --
Other 356 1,000 (546) --
--- --- --- ---
Total 3,323,018 2,761,917 1,737,668 (113,448)
Deductions
Bad debts -- -- -- 132,013
Interest 1,778,953 1,477,807 543,077 274
Depreciation 1,748,335 1,222,686 316,192 3,228
Consulting fees -- -- -- --
Commissions -- 4,000 -- --

Other 20,752 22,784 29,683 37,094
---------- ---------- ---------- ----------
Total 3,548,040 2,727,277 888,952 172,609
Net income (225,022) 34,640 848,716 (286,057)
NOL (89,235) (410,736) (458,721) --
Special ded. (96,479) (82,625) (86,412) (31,960)
---------- ---------- ---------- ----------
Taxable income (410,736) (458,721) 303,583 (318,017)

Assets
Cash 53,976 11,933 322,645 1,241,888
Pooled funds 38,250 -- -- --
Notes Receiv. 1,868,086 1,649,390 2,528,266 1,156,439
Loans
Stockholders 292,479 -- -- --
Subsidiaries -- 292,569 345,869 --
Others 1,543,454 1,146,668 1,186,973 620,594
Securities
Short term 422,000 415,000 -- --
Marketable 230,451 -- -- --
Nonmarketable 4,430,107 4,848,613 5,291,069 5,718,826
Invest. sub. 65,000 65,000 65,000 65,000
Invest. pship. 1,129,898 1,041,875 1,194,093 345,491
Deprec. assets 11,286,020 11,286,020 23,721 23,721
Less acc. dep. (9,385,237) (10,607,923) (20,494) (23,721)
Other 2,365 2,365 2,365 2,365)
---------- ---------- ---------- ----------
Total 11,976,849 10,151,510 1 0,939,507 9,150,603
Liabilities
Payables -- -- -- --
Short term 81,250 122,925 45,490 45,490
Long term 11,258,179 9,995,705 9,49 5,319 9,495,280
Defer. gain 1,777,711 1,569,599 2,4 59,893 1,100,516
Other -- -- -- --
---------- ---------- ---------- ----------
Total 13,117,140 11,688,229 1 2,000,702 10,641,286
Net assets (1,140,291) (1,536,719) (1,061,195) (1,490,683)

Capital stock
Preferred -- -- -- --
Common 100 100 100 100
Capital surplus
Retained earn. (1,140,391) (1,536,819) (1,061,295) (1,490,783)

1988-89
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
In December 1988, IRA acquired 850 shares (85 percent) of Decisions Holding Corp. in a section 351 exchange for all of its shares of Cedilla Invest. and Zeus, plus $60,000. [FN25] Zeus continued to hold an $807,028 receivable from Holding Co. plus $64,000 of receivables (exchanged during 1988 for a $64,000 receivable from HELO). No payments were made by Holding Co. or the others on the receivables, and no efforts were ever made to collect on the receivables.
IRA's consolidated returns for 1988 and 1989 reported consolidated net losses, and net income or loss for Cedilla Investment Co., Zeus, and Decisions Holding Corp. and reflected the following income and end-of-year balance sheets with respect to IRA (unconsolidated):

1988 1989
---------- ----------
Consolidated income (loss) ($637,842) ($116,521)
Cedilla Invest.
Net 52,446 11,702
NOL (704,460) (652,014)
---------- ----------
Taxable (652,014) (640,312)
Zeus
Net (163,987) (18,419)
NOL (181,747) (345,734)
---------- ----------
Taxable (345,734) (364,153)
Decisions Holding Corp.

Net income (1,066,348) (3,394)
NOL (1,066,348)
---------- ----------
Taxable income (1,066,348) (1,069,742)
IRA
Income
Dividends 65,093 --
Interest 180,828 120,555
Gross rents 188 --
Capital gain 293,593 780,343
Partnerships 106,970 110,087
Commissions/fees ---------- ----------
Total 646,672 1,010,985
Deductions
Commissions/fees
Other 44,001 59,927
---------- ----------
Total 44,001 59,927
Net income 602,671 951,058
NOL (311,625) (419,626)
Special deductions (52,074) --
---------- ----------
Taxable income 238,972 531,432
Assets
Cash $1,320,716 $611,752
Notes Receivable 879,079 --
Loans
Stockholders -- --
Others 554,969 1,309,744
Securities -- --
Marketable
Nonmarketable 6,145,610 6,806,346
Investment in sub. 125,000 125,000
Investment in pship. 390,091 478,847
Other 2,365 2,365
---------- ----------
Total 9,417,830 9,334,054

Liabilities
Payables/notes
Short term -- --
Long term 9,495,280 9,495,280
Deferred gain 836,581 --
Other ---------- ----------
Total 10,331,861 9,495,280
Net assets (914,031) (161,226)
Capital stock
Preferred -- --
Common 100 100
Capital surplus
Retained earnings (914,131) (161,326)

IRA's records show the following assets (unconsolidated) for the years 1983 through 1989:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
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******** This is piece 1. -- It begins at character 1 of table line 1. ********

****

IRA Assets 1983 1984 1985 1986

---------- ---------- ---------- ---------- ---------- --

Cash and CD's
Amer. Natl Bank $58,322 $2,047 -- --
Skylark Bank 49,966 49,966 - -
Perinne Bank 1,993 1,963 -- --
Administration 38,250 38,250 -- --
Co.
CD's 3,776,000 422,000 415,000 -
Special E -- -- 11,933 322,645
Principal -- -- -- --
Services

---------- ---------- ---------- ---------- --

Total 3,924,531 514,226 426,933 322,645
Notes Rec.
PMS Note 2,070,128 1,868,086 1,649, 390 1,412,666
Aura -- -- 175 --
Kanter -- -- 16,612 --
Funding Sys. 183,750 122,500 -- --
The Holding Co. 5,027 -- 45,000 64,000
Int'l Films 532,420 535,520 504,548 507,648
HELO 510,100 502,100 495,500 485,825
Tanglewood 350,000 350,000 -- --
Cedilla Invst. 292,260 292,479 292, 569 345,869
B. DiLanciano 3,334 3,334 3,334 --
Larry Freeman 8,351 -- -- --
KWJ Co. -- 30,000 75,500 1 13,500
Landing -- -- 6,000 --
Forest Activity -- -- -- 16,000
Hyatt Corp. -- -- -- 1,115,560
Cablevision Sys. -- -- -- --
Bea Ritch Trust -- -- - --
MAF, Inc. -- -- -- --
CMB Cin. Vent. -- -- -- --
RWL Cin. Trust -- -- -- --

Decisions -- -- -- --
Holding
Carlco -- -- -- --
TMT -- -- -- --

---------- ---------- ---------- ---------- --

Total 3,955,370 3,704,019 3,088,628 4,061,068
Invest. in Stocks
Newell $14,535 -- -- --
Marmom Group 284,009 -- -- --
Micro Z 74,200 -- -- --
Enterp. Tech. 10,664 -- -- --
Composit Cont. 115,000 $115,000 -- --
Modular Pwr. 12,200 12,200 -- --
Greenwich Pharm. 9,219 -- -- --
Funds for Energy 45,000 45,000 -- --
Int'l Films 65,000 65,000 $65,000 $65,000
Cedilla Invst. 15,000 15,000 15,000 15,000
Zeus 50,000 50,000 50,000 50,000
Walnut Capital 40,000 40,000 40,000 40,000
Geocham 87,700 87,700 -- --
Carlco 6,000 1,856,942 2,040,992 2,203,362
BWK 6,000 417,321 458,221 494,303
TMT 6,000 1,962,144 2,243,400 2,488,403
Brajdas -- 58,251 -- --
Hyatt Air -- 1,000 1,000 --
Decision -- -- -- --
Holdings

---------- ---------- ---------- ---------- --

Total 840,527 4,725,558 4,913,613 5,356,068
Partnerships
Micro Z 26,191 28,387 30,104 31, 059
Brickell 135,245 160,559 1 69,885 180,205
Biscayne
TicketMaster 39,631 39,624 39,617 39,615
Polar 1,181,470 879,177 576,587 274,069
May Invest (2,559) (388) (231) (663)
Sandburg Village 650,975 656,929 64 3,088 581,006

UP Associates (211,287) (329,185) (447,41 9) (449,561)
Essex 45,283 -- -- --
Sherwood (51,742) -- -- -- .
Chicago (90,375) (156,319) (224,202) (292,880)
Cablevision
Cablevision (82,547) (148,886) 254, 446 --
Prog.
HICIP -- -- -- 831,243
---------- ---------- ---------- ---------- --
Total 1,640,285 1,129,898 1,0 41,875 1,194,093
Rental property
Cost 11,262,299 11,262,299 11,262,2 99 --
Accum. dep. (7,628,162) (9,371,728) (10,5 90,882) --
---------- ---------- ----------
Total 3,634,137 1,890,571 671,417 --
Other total 17,346 12,577 9,045 5,592
---------- ---------- ---------- ---------- --

Total assets 14,012,196 11,976,849 10,151,511 10,939,466
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70....+....
****
********** This is piece 2. -- It begins at character 80 of table line 1. *********
****
1987 1988 1989
---------- ---------- ----------

-- -- (8,248)
- - -
-- -- --
-- -- --

915,000 998,051 620,000
-- -- --
326,888 322,665 --

---------- ---------- ----------
1,241,888 1,320,716 611,752

1,156,439 879,079 --
-- -- --
-- -- 600,000
-- -- --
76,743 76,743 76,743
-- -- --
-- -- --
-- -- --
-- -- --
-- -- --
-- -- --
161,500 181,500 249,870
-- -- --
-- -- --
-- -- --
181,247 90,624 --
200,000 200,000 200,000
1,002 -- --
102 102 102
-- 6,000 6,000
-- -- 400

-- -- 122,355
-- -- 54,274
---------- ---------- ----------
1,777,033 1,434,048 1,309,744

-- -- --
-- -- --
-- -- --
-- -- --
-- -- --
-- -- --

-- -- --
-- -- --
-- -- --
$15,000 -- --
50,000 -- --
80,000 $80,000 $80,000
-- -- --
2,395,676 2,558,437 2,936,627
530,473 566,642 650,684
2,712,677 2,940,531 3,139,035
-- -- --
-- -- --
-- 125,000 125,000

--------- ---------- ----------
5,783,826 6,270,610 6,931,346

31,059 30,041 30,032
-- -- --

39,615 -- --
(3,269) (3,356) (3,356)
1,138 (2,298) (2,439)
-- -- --
(542,452) (542,489) (542,803)
-- -- --
-- -- --
(337,678) (364,038) (384,914)

-- -- --

1,157,078 1,272,231 1,382,327
--------- --------- ---------
345,491 390,091 478,847

-- -- --
-- -- --

-- -- --
2,365 2,365 2,365
--------- ---------- ----------

9,150,603 9,417,830 9,334,054
80..+...90....+....0....+...10....+...

IRA and its subsidiaries' consolidated total income, taxable income, net operating losses, and taxes paid for the years 1978 through 1989 were as follows:

Year	Total Income	Taxable Income	Net Operating Losses	Tax Paid
1978	$1,004,475	($18,673)	($27,394)	--
1979	1,944,332	404,771	(18,673)	$94,618
1980	3,557,198	65,094	--	--
1981	5,158,583	(615,852)	--	--
1982	4,536,122	(121,501)	(143,987)	--
1983	3,849,742	(435,535)	(121,501)	--
1984	3,606,785	(175,964)	(89,235)	--
1985	3,118,893	96,363	(175,946)	--
1986	2,345,762	(328,854)	--	--
1987	299,794	(16,942)	(111,843)	--
1988	(526,393)	(637,842)	(10,550)	--
1989	1,011,577	(116,521)	(1,057,468)	10,819

IRA and its subsidiaries' consolidated total income, rental income, and difference for the years 1978 through 1989 were as follows:

Year	Total Income	Rental Income	Difference
1978	$1,004,475	$241,072	$ 763,403
1979	1,944,332	242,818	1,701,514

1980 3,557,198 831,264 2,725,934
1981 5,158,583 2,740,082 2,418,501
1982 4,536,122 2,681,385 1,854,737
1983 3,849,742 2,820,494 1,029,248
1984 3,606,785 2,928,019 678,766
1985 3,118,893 2,928,019 190,874
1986 2,345,762 1,627,094 718,668
1987 299,794 9,940 298,854
1988 (526,393) 188 (526,205)
1989 $1,011,577 -- 1,011,577

On the consolidated returns, IRA reported that it paid (not including payments by subsidiaries) the following compensation of officers, compensation of directors, salaries and wages, commissions, and consulting fees for the years 1976 through 1989:

Year	Officers	Directors	Wages	Commissions	Consulting
1976	--	--	$213,333	--	
1977	$19,300	--	$986	12,000	--
1978	15,000	--	5,051	207,237	$51,900
1979	--	--	209,440	125,000	
1980	--	--	--	--	
1981	--	$12,500	9,969	115,400	--
1982	--	--	26,079	--	29,000
1983	--	--	--	--	
1984	--	--	--	--	
1985	--	--	4,000	--	
1986	--	--	--	--	
1987	--	--	--	--	
1988	--	--	--	--	
1989	--	--	--	--	

H. Changes in Holding Co. & Subsidiaries Corporate Structure 12/76 Through 8/87
Holding Co. was incorporated on December 8, 1976. Holding

Co.'s return for the fiscal year ending August 31, 1978, indicates that Kanter owned 75 percent of Holding Co.'s voting stock as of the close of the taxable year. The return indicates that preferred shares as well as common shares of stock were outstanding at that time.
12/76 Through 8/31/77
By August 31, 1977, Holding Co. had acquired Citra Co. (Citra).
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/77 Through 8/31/78
On November 25, 1977, Holding Co. had acquired 1,000 shares (100 percent) of the common stock (no preferred stock was issued) of The Active Business Corp. (Active). On July 21, 1978, Active acquired 500 shares (100 percent) of the voting stock of Harbor Investments, Inc., which later changed it name to Harbor Exchange Lending Operation (HELO).
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/78 Through 8/31/79
On May 22, 1979, Holding Co. acquired 1,000 shares (100 percent) of the voting stock of Oil Investments, Ltd. (Oil Investments).
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/79 Through 8/31/80
Holding Co. acquired 1,000 shares (100 percent) of the voting stock of The Nominee Corp. (Nominee) on January 7, 1980, and 100 shares (100 percent) of the voting stock of Tanglewood Properties, Inc., on April 30, 1980. Harbor Investments changed its name to Harbor Exchange Lending Operations (HELO) between September 1, 1979, and August 31, 1980.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/80 Through 8/31/81

Holding Co. acquired the voting stock of L.B.G. Properties, Inc. (LBG Prop.), in November 1980, Zion in December 1980, and Twilight Properties, Inc. (Twilight), in April 1981.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/81 Through 8/31/83
Between August 31, 1981, and August 31, 1983, Holding Co. acquired 100 percent of the voting shares of Columbus Projects, Inc. (Columbus), PPPD, Inc. (PPPD), and PPPI, Inc. (PPPI). In 1981 Frey began making payments to Zion, and in 1982 Essex began making payments to Holding Co.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/83 Through 8/31/84
In 1984, Schaffel began making payments to Holding Co. On August 31, 1984, Holding Co. sold or liquidated all of its stock in Active, Citra, Columbus, HELO, PPPD, and PPPI.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/84 Through 8/31/85
On August 31, 1985, Holding Co. sold or liquidated its stock in Nominee. It reacquired the stock in Nominee on September 1, 1986.
I. Holding Co. & Subsidiaries Returns
The consolidated returns of Holding Co. and its subsidiaries show the following with respect to taxable years ending July 31, 1977 to 1987:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents.
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divided into multiple pieces with each piece containing information to help you
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	8/31/77	8/31/78	8/31/79	8/31/80
Income (loss)				
Consolidated				
Income --	$594,653	$900,572	$1,076,933	
Deductions --	(613,972)	(813,324)	(939,205)	
Net --	(19,319)	87,248	137,728	
NOL & Special --	(112,776)	(160,468)	(99,377)	
Taxable --	(132,095)	(73,220)	38,351	
Active				
(acq.11/77)				
Income --	59,961	28,387	49,902	
Deductions --	(1,106)	(3,468)	(5,863)	
Net --	58,855	14,919	44,039	
NOL --	--	(1,658)	--	
Taxable --	58,855	13,261	44,039	
Citra				
Income --	19,327	82	6	
Deductions --	(335)	(211)	(1,221)	

Net -- 18,992 (129) (1,215)
NOL -- -- -- (129)
---------- ---------- ----------
Taxable -- 18,992 (129) (1,344)
HELO
(acq.7/78)
Income -- -- -- 1,485
Deductions -- -- (115) (31,309)
---------- ----------
Net -- -- (115) (29,824)
NOL -- -- -- (115)
---------- ----------
Taxable -- -- (115) (29,939)
Nominee
Income -- -- -- --
Deductions -- -- -- (31)

Net -- -- -- (31)
NOL -- -- --
Taxable -- -- -- (31)
Oil Investments
Income -- -- -- (444,493)
Deductions -- -- (54) (28,227)
---------- ----------
Net -- -- (54) (472,720)
NOL -- -- -- (54)

Taxable -- -- (54) (472,774)
Tanglewood
Income -- -- -- $246,059
Deductions -- -- -- (241,573)

Net -- -- -- 4,486
NOL -- -- -- --

Taxable -- -- -- 4,486
Holding Co.

Income
Dividends -- $118,940 $35,069 30,773
Interest -- 284,413 449,889 182,802
Gross rents -- 182,357 264,538 264,338
Capital Gain -- (35,277) 272,693
Partnerships -- (118,638) 58,819 (240,878)
Commissions -- 92,792 63,788 75,000
Consulting fees -- -- -- --
Condo conversion -- -- -- 579,394
Other 59,852
---------- ---------- ----------
Total 524,587 872,103 1,223,974
Deductions
Bad debts -- -- -- --
Interest -- 176,936 477,517 372,691
Depreciation -- 442,276 315,911 225,651
Commissions
Consulting -- -- -- 15,000
Legal & profess. -- -- 5,796 15,297
Other -- 2,541 252 2,342
---------- ---------- ----------
Total -- 621,753 799,476 630,981
Net Income -- (97,166) 72,627 592,993
NOL -- -- (209,008) (166,190)
Special ded. -- (112,776) (29,809) (26,157)
---------- ---------- ----------
Taxable Income -- (209,942) (166,190) 400,646
Holding Co.
Assets -- -- -- -- --
Cash 27,199 3,012 (14,850) 31,613
Dividends receiv. -- 77,847 -- --
Mortgage Loan -- 94,479 14,479 --
Loans
Stockholders 161,500 197,638 40, 316 --
Subsidiaries
Others 2,371,000 5,325,153 12,18 8,227 15,378,662
Securities

Marketable $263,887 $2,177,889 $ 1,299,799 $2,076,472
Nonmarketable 34,956 99,888 207,139 511,042
Invest. sub. 50,000 100,000 178,849 180,849
Invest. pship. 70,890 82,406 350,033 42,755
Deprec. assets -- 1,547,966 1,547,966 1,547,966
Less acc. dep. -- (442,276) (758,187) (983,838)
Land -- -- -- 5,000
Other 9,899 3,039 2,999 4,103

Total 2,989,331 9,267,041 15, 056,770 18,794,624
Liabilities
Loans/notes
Short-term 550,000 833,758 1,142,616 579,246
Long-term 2,269,000 6,743,486 13,150,752 16,528,988
Stockholder 45,000 138,000 -- 126,431
Subscription -- -- 45,000 45,000
Due broker -- 1,068,091 36 3,498 567,487
Other 86,314 131,946 -- --

Total 2,950,314 8,915,281 14,701,866 17,847,152
Net assets 39,017 351,760 354,904 947,472
Capital stock
Preferred 275 50,778 50,778 50,778
Common 2 23 23 23
Capital surplus 49,723 407,086 407,086 407,086
Retained earn. (10,983) (106,127) (102,983) 489,585
HELO
Assets
Cash -- -- 231 4,294
Pooled funds -- -- - 718
Loans receiv. -- -- -- --
Others -- -- -- 2,871,082
Other -- 500 151 120

Total 500 382 2,876,214
Liabilities
Payables -- -- -- --

Short-term -- -- -- 322,987
Long-term -- -- -- 1,327,100
Shareholder -- -- -- 1,255,600

Total -- -- -- 2,905,687
Net assets -- 500 382 (29,473)
Capital stock
Preferred -- -- -- --
Common -- 500 500 500
Capital surplus -- -- -- --
Retained earn. -- -- (1 18) (29,973)

8/31/83 8/31/84 8/31/85 8/31/86

Income (loss)
Consolidated
Income -- 2,747,847 5,453,080 2,103,200
Deductions -- (3,982,819) (4,028,682) (1,824,013)
Net -- (1,234,972) 1,424,398 279,187
NOL & special -- (6,317,893) (7,355,261) (5,932,002)
Taxable (6,316,713) (7,552,865) (5,930,863) (5,652,815)
Active
Income -- (22,311) -- --
Deductions -- (71,467) -- --
Net -- (93,778) -- --
NOL -- (1,648,466) -- --
Taxable (1,648,466) (1,742,244) -- --
Citra
Income -- 60 -- --
Deductions -- (699) -- --
Net -- (639) -- --
NOL -- -- -- --
Taxable (639) (639) -- --
Columbus Projects
Income -- (41,684) -- --
Deductions -- (169) -- --
Net -- (41,853) -- --

NOL -- (70,273) -- --
Taxable (70,273) (112,126) -- --
HELO
Income -- 136 -- --
Deductions -- (30) -- --
Net -- 106 -- --
NOL -- (198,135) -- --
Taxable (198,135) (198,029) -- --
LBG Properties
Income -- 257,663 219,000 382,823
Deductions - (277,218) (219,062) (461,384)
Net -- (19,555) (62) (78,561)
NOL -- (273,136) (292,691) (292,753)
Taxable (273,136) (292,691) (292,753) (371,314)
Nominee
Income -- -- 52 --
Deductions -- (618) (290) --
Net -- (618) (238) --
NOL -- (512) (1,130) --
Taxable (512) (1,130) (1,368) --
Oil Investments
Income -- (81,457) 8,088 (121,884)
Deductions -- (430) (11,623) (3,689)
Net -- (81,887) (3,535) (125,573)
NOL -- (1,652,325) (1,734,212) (1,737,747)
Taxable (1,652,325) (1,734,212) (1,737,747) (1,863,320)
PPPD, Inc.
Income -- -- -- --
Deductions -- (375) -- --
Net -- (375) -- --
NOL -- (292) -- --
Taxable (292) (667) -- --
PPPI, Inc.
Income -- -- -- --
Deductions -- (365) -- --
Net -- (365) -- --
NOL -- (283) -- --

Taxable (283) (648) -- --
Tanglewood
Income -- 836,977 313,280 290,446
Deductions -- (763,046) (322,830) (462,098)
Net -- 73,931 (9,550) (171,652)
NOL -- (260,287) (186,356) (195,906)
Taxable (260,287) (186,356) (195,906) (367,558)
Twilight Prop.
Income -- 1,336,393 3,531,431 45,893
Deductions -- (2,334,351) (2,537,970) (260,027)
Net -- (997,958) 993,461 (214,134)
NOL -- (2,316,873) (3,314,831) (2,321,370)
Taxable (2,316,873) (3,314,831) (2,321,370) (2,535,504)
Zion
Income -- (93,233) (262,786) (315,749)
Deductions -- (396) (354) (1,120)
Net -- (93,629) (263,140) (316,869)
NOL -- (216,308) (309,937) (573,077)
Taxable (216,308) (309,937) (573,077) (889,946)
Holding Co.
Income
Dividends -- 1,388 500 2,949
Interest -- 60,937 75,996 175,522
Gross rents -- 262,138 262,138 129,200
Capital gain -- 487,794 821,186 (229,447)
Partnerships -- (343,048) (352,711) (219,551)
Commissions -- 14,341 266,650 1,100,000
Other fees -- 69,496 414,036 441,723
Condo conversion -- -- --
Other -- 2,257 156,220 --
--- --- ---
Total -- 555,303 1,644,015 1,400,396
Deductions
Bad debts -- -- 30,000 45,000
Interest -- 68,129 146,076 141,905
Depreciation -- 135,847 8,511 21,167
Commissions/fees -- 875 600,000 175,000

Legal & profess. -- 302,900 116,492 222,678
Other -- 25,904 35,474 29,945
---------- ---------- ----------
Total -- 533,655 936,553 635,695
Net Income -- 21,648 707,462 764,701
NOL -- -- -- (1,149,287)
Active -- -- (1,742,244) --
Citra -- -- (639) --
Columbus Proj. -- -- (112,126) --
PPPD -- -- (667) --
PPPI -- -- (648) --
Special ded. -- (1,180) (425) (2,507)
---------- ---------- ----------
Taxable income -- (20,468) (1,149,287) (387,093)
Holding Co.
Assets
Cash 103,880 215,579 190,832 129,934
Pooled funds 18,882 119,338 677,730 1,127,458
CD -- -- -- 1,060,000
Loans -- -- -- --
Stockholders 111,301 19,785 19,785 975,000
Others 5,219,398 4,023,564 4,476,787 2,218,852
Securities
Marketable 788,807 1,351,225 1,712,093 358,991
Nonmarketable 336,451 276,075 227,735 234,402
Invest. sub. 223,932 36,060 36,060 25,060
Invest. pship. (1,509,414) (3,628,091) (4,429,619) (4,191,984)
Condominiums -- -- -- 250,484
Deprec. assets 1,549,027 1,557,732 1,844,476 1,844,476
Less acc. dep. (1,413,981) (1,549,828) (1,558,338) (1,579,505)
Other 2,910 2,910 9,743 11,603
---------- ---------- ---------- ----------
Total 5,431,193 2,424,349 3,2 07,284 2,464,771
Liabilities
Loans/notes -- -- -- --
Short-term 2,046,772 1,404,904 1,484,337 --
Long-term 923,529 991,950 1,045,743 --

Stockholder 425,528 33,620 -- --
Deferred income 26,238 11,554 11,554 --
Other 49,750 4,750 4,750 --
---------- ---------- ----------
Total 3,471,817 2,446,778 2,546,384 --
Net assets 1,959,376 (22,429) 660,900 --
Capital stock
Preferred 50,780 50,780 -- --
Common 23 23 -- --
Capital surplus 1,907,085 1,907,085 -- --
Retained earn. 1,488 (1,980,317) -- --
HELO
Assets -- -- -- --
Cash 31 322 -- --
Pooled funds -- 4,636 -- --
Loans Receiv. 2,331,326 1,320,059 -- --
Other assets 27 -- -- --
---------- ----------
Total 2,331,384 1,325,017 -- --
Liabilities
Payables
Short-term 2,518,589 -- -- --
Long-term 10,557 1,522,700 -- --
---------- ----------
Total 2,529,146 1,522,700 -- --
Net assets (197,762) (197,683) -- -
Capital stock
Preferred -- -- -- --
Common 500 500 -- --
Capital surplus
Retained earn. (198,262) (198,183) -- --
Zion
Assets
Cash (84) 7 55 9,719
Pooled funds -- 2,818 7,100 --
Marketable sec. -- 127,280 127,280 65,695
Invest. pship. 840,362 618,059 344,295 85,912

Other 5,345 2,524 -- --
---------- ---------- ---------- ----------
Total 845,623 750,688 478,730 161,326
Liabilities
Loans/notes
Short-term 9,264 3,014 -- --
Long-term 104,694 104,694 99,871 --
Stockholder 629,650 636,000 636,000 636,000
Other -- -- -- 99,336
---------- ---------- ---------- ----------
Total 743,608 743,708 735,871 735,336
Net assets 102,015 6,980 (257,141) (574,010)
Capital stock
Preferred 8,000 8,000 8,000 8,000
Common 100 100 100 100
Capital surplus 133,250 133,250 133,25 0 133,250
Retained earn. (39,335) (134,370) (398,491) (715,360)
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70....
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******** This is piece 2. -- It begins at character 75 of table line 1. ********
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8/31/81

$1,110,335
(3,828,869)

(2,718,534)
(80,124)

(2,798,65 8)

23,768
(4,381)

19,387
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19,387

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(20)
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(20)
(1,344)

(1,364)

4,597
(149,974)

(145,377)
(29,939)

(175,316)

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(1,589)

(1,589)
(31)
(1,620)

(619,431)
(5,637)

(625,068)
(472,774)

(1,097,842)

$818,591
(1,122,339)

(303,748)
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(303,748)

78,130
80,077
264,938

(405,693)
344,175
150,000
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511,627

799,552
1,160,279
161,179

600
2,689
14,192

2,138,491
(1,626,864)
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(66,950)

(1,693,814)

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(590,353)
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4,228,168

$235,609
455,828
194,447
263,305
1,547,966
(1,145,017)
5,000
3,170

5,198,123

2,546,566
1,352,085
334,983
53,000
651,595
969

4,939,198
258,925

1,550,778
23
407,086
(1,698,962)

(879,704)
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4,691,912
348

3,812,556

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849,680
3,127,200
10,557

3,987,437
(174,881)

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500
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(175,381)

8/31/87

607,736
(1,118,480)
(510,7 44)
(5,655,428)
(6,166,172)

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300,000
(300,067)
(67)
(371,314)
(371,381)

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(80)
(80)
(1,371)
(1,451)

11,981
(291)
11,690
(1,863,320)
(1,851,630)

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196,544
(184,525)
12,019
(367,558)
(355,539)

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(2,535,504)
(2,535,504)

(84,538)
(120)
(84,658)
(889,946)
(974,604)

3,266
145,483
18,400
(32,398)
(630,754)

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588,796
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(498)

92,295

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633,397
(541,102)
(387,093)
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(2,613)

(930,808)

(396,758)
1,048,386
970,500
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700,000
4,490,268

198,991
235,903
36,060

(4,608,659)
250,484
251,051
(45,753)
133,723

3,264,196

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9,094
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57,306
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66,400

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725,801
(659,401)

8,000
100
133,250
(800,75 1)
75..80....+..

J. HELO 1979 Through 1983
Holding Co.'s consolidated returns reflect the following income (all interest), deductions, net assets, and stockholder equity with respect to HELO:

08/78 08/79 08/80 08/81 08/83 08/84
---- ---- ---- ---- ---- ----

Interest	$-0-	$1,485	$4,597	N/A	$136
Deductions	(115)	(31,309)	(149,974)		(30)
Total	(115)	(29,824)	(145,377)		106
NOL		(115)	(29,939)	(198,135)	
Taxable		(115)	(29,939)	(175,316)	(198,029)
Assets					
Cash	$500	131	4,294	(879,704)	$31 322
Receivables		2,871,082	4,691,912	2,331,326	1,320,059
Money market			718	259	
Pooled funds				4,636	
Intangibles		151	120	89	27
Total	500	382	2,876,214	3,812,556	2,331,384 1,325,017
Liabilities					
Loans					
Short-term		322,987	849,680	2,518,589	1,522,700
Shareholder			1,255,600	10,557	
Long-term			1,327,100	3,127,200	10,557
Total	-0-	-0-	2,905,687	3,987,437	2,529,146 1,522,700
Net assets	500	382	(29,473)	(174,881)	(197,762) (197,683)
Capital stock	500	500	500	500	500 500
Retained earnings		(118)	(29,973)	(175,381)	(198,262) (198,183)

IV. Flow of Money

A. Payments to IRA and Subsidiaries: The Prudential Transactions

1. Overview

The payments related to the Prudential transactions paid by the Five to IRA and its subsidiaries during the years 1977

through 1989, were as follows:

Year	Hyatt 1	Schaffel	Frey	PMS	Essex	Total
1977	$38,394					$38,394
1978	42,517					42,517
1979	119,719	$100,000		$303,088		522,807
1980	244,920	$127,372		380,337		752,629
1981	90,070	361,525		105,764	534,696	1,092,055
1982	172,702	447,450		538,781	361,692	$86,212 1,606,837
1983	172,090	30,981		110,125	361,692	78,376 753,264
1984	186,092	103,500		361,692	133,238	784,522
1985	206,790	128,763		361,692	120,175	817,420
1986	231,263	361,692		80,466		673,421
1987	229,449	361,692		120,698		711,839
1988	197,348	361,692		117,563		676,603
1989	52,777	840,423		51,727		944,927
Total	1,739,211	1,184,876		1,114,305	4,590,388	788,455
$9,417,235						

FN1. Net Weaver's 30%.

Prior to 1984, all payments related to the Prudential transactions were paid to IRA or one of its subsidiaries. By early 1982, Ballard and Lisle had left Prudential. During 1982 Carlco, TMT, and BWK, Inc. were formed. In 1983 the three corporations became part of IRA's consolidated group, KWJ Corp. was liquidated, and the funds accumulated by Zeus were distributed to IRA. In 1984, IRA distributed the funds that had been accumulated from the Prudential transactions in the ratio of 45 percent to Carlco, 45 percent to TMT, and 10 percent to BWK, Inc. From 1984 through 1989, most payments related to the Prudential transactions were paid to or distributed to Carlco, TMT, and BWK, Inc.

2. Flow of the Funds 1977 Through 1983

The following diagram shows the money paid by the Five to

IRA, Zeus, and KWJ Corp. from 1977 through 1983 with respect to the Prudential transactions:
1977-1983
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Prior to 1984, all payments by the Five in connection with the Prudential transactions were reported on the consolidated returns of IRA. No tax was paid on this income because, during the years 1978 through 1983, IRA reported substantial net operating losses. IRA reported the following consolidated total income, taxable income, and net operating losses for the years 1978 through 1983:

Year	Total Income	Taxable Income	Net Operating Losses
1978	$1,004,475	($18,673)	($271,394)
1979	1,944,332	404,771	(18,673)
1980	3,557,198	65,094	--
1981	5,158,583	(615,852)	--
1982	4,536,122	(121,501)	(143,987)
1983	3,849,742	(435,535)	(121,501)

a. Flow of Money From KWJ Corp. to IRA: 1978 Through 1983
IRA acquired all of KWJ Corp.'s stock from Weaver in 1979. At the time of the purchase, KWJ Corp. had net assets of $115,084. IRA's consolidated returns from 1979 through 1983 reported the following income, net assets, and stockholder equity with respect to KWJ Corp.:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents.
The table has been divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)

a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]

********** ******** This is piece 1. -- It begins at character 1 of table line 1. ******** **********

	1978	1979	1980	1981	1982
Income					
Commission	--	$171,027	--	$128,671	$246,717
Interest - 703	--	2,512	6,237		
Total	--	171,730	--	131,183	252,954
Deductions	--	--	--	--	--
Commission	--	51,308	--	38,601	74,015
Consulting	--	--	--	--	21,000
Other	--	776	$2,620	1,464	2,097
Total	--	52,084	2,620	40,065	97,112
Net Income	--	119,646	(2,620)	91,118	155,842
Assets	$40,626	--	--	--	--
Cash	108,521	3,095	503	1,828	79,950
Accrued income	--	171,000	--	--	--
Pool funds	--	--	--	--	76,720
Loans					
Stockholders(IRA)	--	171,000	262,400	2,400	
Others	--	66,241	66,241	--	--

Total 149,147 $240,364 237,744 264,228 159,070
Liabilities 34,063 65,634 65,634 1,000
--- --- --- --- ---
Net assets 115,084 174,730 172,110 263,228 159,070
-- -- -- -- --
Capital stock 1,000 1,000 1,000 1,000 1,000
Capital surplus -- -- -- -- --
Retained earnings 114,084 173,730 171,110 262,228 158,070

Distributions -- 60,000 -- -- 260,000
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70....+....
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********** This is piece 2. -- It begins at character 80 of table line 1. *********
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1983 Total
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$245,84. 792,258
4,356 13,808
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250,199 806,066
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73,753 23 7,677
36,000 57,000
663 7,620
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110,416 302,297
139,783 503,769

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298,853 --

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80..+...90....+....0....

KWJ Corp. paid Weaver a total of $237,677 as commissions from 1979 through 1983. KWJ Corp. paid $21,000 as consulting fees to unidentified payees during 1982. KWJ Corp. paid three of Ballard's and Lisle's children (Melinda Ballard, Thomas Lisle, and Amy Albrecht) $1,000 each month during 1983 and deducted the $36,000 as consulting expenses for 1983. KWJ Corp. had a total of $7,620 in other expenses from 1979 through 1983.
In 1979, KWJ Corp. distributed $60,000 to IRA. During 1981 KWJ Corp. distributed $262,400 to IRA that was treated as a loan from KWJ Corp. to IRA. In 1982, an offset of $260,000 of the loan was treated as a dividend distribution to IRA. In 1983, IRA repaid the remaining $2,400 loan. During 1983, KWJ Corp. was liquidated, and $298,853 was distributed to IRA.
From 1979 through 1983, KWJ Corp. had available or received a total of $921,150 from the following sources:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
KWJ Corp. distributed the $921,150 as follows:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

b. Flow of Money From Zeus: 1979 Through 1983
In 1979, IRA organized Zeus and acquired all the common stock for $50,000. The $50,000 paid by IRA for the stock was recorded on the books as $100 for the common stock and $49,900 as paid in capital. IRA also lent Zeus $50,000. In 1979, Zeus purchased a 6.14-percent interest in Village of Kings Creek (Frey's first condominium conversion project) for $100,000.
The Frey corporation paid the following amounts to Zeus during the years 1980 through 1983:

Year	Payment
1980	$127,372
1981	105,764
1982	538,781
1983	110,125
Total	$882,042

All of Zeus' income from its incorporation through 1983 is attributable to the payments from the Frey corporation, interest income, and partnerships (including Frey condominium partnership, the Village of Kings Creek, and the Greens). IRA's consolidated returns for 1979 through 1983 reported the following income, net assets, and stockholder equity with respect to Zeus:

	1979	1980	1981	1982	1983
Income					
Interest	--	--	--	$64,688	$55,104
Commission	--	$127,372	$64,574	538,781	110,125
Partnership	--	--	2,382	(150,907)	(15,049)
Other fees	--	--	32,567	--	--
Misc.	--	--	8,625	12	--

Total income	--	127,372	108,148	452,574	150,180
Deductions	--	9,103	261	3,883	1,052
Taxable	--	118,269	107,887	448,691	149,128
Nontaxable	--	--	--	--	--
Partnership	--	6,828	--	(27,061)	(753)
Assets					
Cash	--	393	27,990	284	7,832
Loan receiv.	--	--	64,000	64,000	866,000
Securities	--	--	--	685,000	--
Money market	--	--	69,002	--	--
Partnerships	$100,000	234,200	172,896	(5,073)	(20,875)
Pooled funds	--	--	--	11,339	--
Intangibles	--	128	96	64	32
Total	100,000	234,721	333,984	755,614	852,989
Liabilities	50,000	59,624	51,000	51,000	--
Net assets	50,000	175,097	282,984	704,614	852,989
Capital stock	100	100	100	100	100
Capital	--	--	--	--	--
surplus	49,900	49,900	49,900	49,900	49,900
Retained	--	--	--	--	--
earnings	125,097	232,984	654,614	802,989	

The $50,000 liability in 1979 and $51,000 of the liabilities reflected on the balance sheet from 1980 through 1982 represented loans outstanding from IRA to Zeus. The $64,000 loan receivable is shown on Zeus' general ledger for 1984 as owed to Zeus by Holding Co .'s subsidiary HELO. At the close of 1982, Zeus had liquid assets of $696,623 ($284 cash, $685,000 money market funds, and $11,339 in pooled funds). During 1983 Zeus received cash income of $165,229 ($55,104 interest and $110,125 commissions) and had cash

expenditures of $1,020 ($1,052 deductions less $32 for capitalized organizational expenses). Thus, during 1983, Zeus had $860,832 in liquid assets ($696,623 + $165,229--$1,020).

On March 25, 1983, Zeus repaid the $51,000 loan outstanding from IRA. On October 21, 1983, Zeus transferred $774,000 to IRA in exchange for a $774,000 receivable from Holding Co. During 1983, Zeus transferred $28,000 to IRA in exchange for $28,000 of receivables from Holding Co. [FN26] Thus, during 1983, Zeus transferred a total of $853,000 in cash to IRA in repayment of a loan and in exchange for Holding Co. receivables.

IRA's 1983 consolidated return reported that Zeus' assets at the end of the year included cash of $7,832, loans receivable of $866,000, partnership interests with a negative value of $20,875, and other assets (capitalized organizational expenses) of $32. From 1979 through 1983, Zeus apparently invested a net of $163,685 in partnerships. [FN27]

From 1979 through 1983, Zeus received a total of $1,111,470 from the following sources:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

Zeus distributed the $1,111,470 of funds as follows:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

c. Payments From Schnitzer-PMS, Essex, and Schaffel 1979 Through 1983

From 1979 through 1983, Essex paid IRA a total of $164,587, PMS paid IRA a total of $1,941,505 in principal and interest on the repurchase of the PMS stock, and Schaffel paid $1,184,876 to IRA representing 50 percent of the broker's fees he received from Prudential transactions. [FN28]

d. Funds Accumulated in IRA at Close of 1983

At the close of 1983, IRA had accumulated $4,771,445 from payments made by the Five related to the Prudential transactions as shown in the following diagram:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT

IS NOT DISPLAYABLE

IRA's balance sheet showed the following assets, liabilities, and stockholder equity at the close of 1983:

Assets
Cash $110,281
Notes/accounts receivable 2,070,128
Loans receivable 1,592,983
Short-term securities 3,776,000
Loans to stockholders 292,260
Investment/partnerships 1,640,284
Investment/subsidiaries 83,000
Marketable securities 564,827
Non-marketable securities 192,700
Pooled funds 38,250
Buildings & other depreciable assets 11,286,020
Less accumulated depreciation (7,636,902)
Deposits 2,365

Total 14,012,196
Liabilities
Short-term mtg., notes, bonds 1,341,617
Long-term mtg., notes, bonds 11,060,633
Deferred gain 1,969,973

Total 14,372,223
Net assets (360,027)
Capital stock 100
Retained earnings (360,127)

3. 1984 Distributions to Carlco, TMT, and BWK, Inc.

In 1984, IRA began distributing cash and other property to Carlco, TMT, and BWK, Inc. The distributions were made in a ratio of 45/45/10 to Carlco, TMT, and BWK, Inc.

a. 1984 Distributions of Cash From IRA to Carlco, TMT, and BWK, Inc.

During 1984, IRA transferred $4,156,739 to Carlco, TMT, and

BWK, Inc. The $1,870,532 to each of Carlco and TMT and $415,675 to BWK, Inc., was distributed on the dates and in the amounts indicated:

Date	Carlco	TMT	BWK, Inc.	Total
01/04/84	$540,000	$540,000	$120,000	$1,200,000
01/10/84	90,000	90,000	20,000	200,000
01/13/84	90,000	90,000	20,000	200,000
01/17/84	112,500	112,500	25,000	250,000
01/24/84	225,000	225,000	50,000	500,000
02/01/84	90,000	90,000	20,000	200,000
02/06/84	112,500	112,500	25,000	250,000
02/07/84	90,000	90,000	20,000	200,000
02/10/84	90,000	90,000	20,000	200,000
02/15/84	45,000	45,000	10,000	100,000
02/22/84	36,900	36,900	8,200	82,000
02/29/84	45,000	45,000	10,000	100,000
03/20/84	142,086	142,086	31,575	315,747
04/12/84	40,500	40,500	9,000	90,000
07/17/84	52,200	52,200	11,600	116,000
07/31/84	11,700	11,700	2,600	26,000
10/10/84	16,456	16,456	3,658	36,570
10/16/84	40,690	40,690	9,042	90,422
Total	1,870,532	1,870,532	415,675	4,156,739

b. 1984 Distribution of Essex Partnership Interest to Carlco, TMT, and BWK, Inc.
For the taxable years 1982 through 1983, Essex made the following distributions to IRA that were reported by IRA in the year indicated:

Payment Date	Year Reported	Amount
09/28/82	1982	$47,025
12/30/82	1983	39,187
06/03/83	1983	26,125
07/08/83	1983	26,125
10/03/83	1983	26,125
Total		164,587

IRA also recorded its distributable share of income from Essex as $89,214 for 1982 and $120,656 for 1983. IRA recorded the value of its interest in Essex as follows:

1982 beginning value --	
Plus 1982 share of income	$89,214
Less 11/30/82 payment	(47,025)
Investment end of 1982	42,189

1983 beginning value	42,189
Plus 1983 share of income	120,656
Less distributions	
01/06/83 dividend	(39,187)
06/07/83 distribution	(26,125)
07/11/83 distribution	(26,125)
10/15/83 distribution	(26,125)
Investment end of 1983	45,283

During 1984, IRA received the following distributions from Essex:

01/26/84	Distrib from Essex $44,413
05/08/84	Essex 26,125
07/06/84	Essex distrib. 26,125
10/04/84	Essex 36,575

IRA recorded the receipt of the $44,413 payment received from Essex in January as payables of $19,986 due to each of

January 30, 1984, IRA issued checks in the appropriate amounts to each of the corporations and recorded the payments as payment of the payables owed to Carlco, TMT, and BWK, Inc. The remaining $88,825 from Essex was also treated as distributed directly to Carlco, TMT, and BWK, Inc., by reducing the additions to capital attributable to IRA's contributions of cash made to the corporations during the year.
In December 1984, IRA distributed its Essex partnership interest in the ratio of 45 percent each to Carlco and TMT and 10 percent to BWK, Inc. IRA recorded the distribution of the Essex partnership interest on its books as follows:

1984 beginning value $45,283
Less distribution of investment as paid in capital (45,283)
Less distributions from Essex
05/08/84 (26,125)

10/04/84 (36,575)
Plus "distb exxex dist as pd in" 88,825

Investment end of year -0-

Carlco, TMT, and BWK, Inc. recorded the receipt of the Essex partnership interest as follows (balance differences are due

Item Carlco TMT BWK Total

Investment in Essex
Beginning year -0- -0- -0- -0-
Essex interest from IRA $20,377 $20,377 $4,528 $45,282
K-1 from Essex 60,520 60,520 13,449 134,489
Distribution from Essex (19,986) (19,986) (4,441) (44,413)
1984 Essex distribution from IRA (39,971) (39,971) (8,882)

(88,824)

End year investment 20,940 20,940 4,653 46,533

Paid in Capital
Essex interest from IRA 20,377 20,377 4,653 45,282
Essex distribution received from IRA (39,971) (39,971) (8,882)
(88,824)

c. Transfer of Sherwood Partnership Interest From IRA to Carlco, TMT, and BWK, Inc.
In 1982, IRA invested $175,000 in a partnership called Sherwood Associates (Sherwood). IRA held a 50-percent interest in Sherwood and reported an $89,577 loss from Sherwood for 1982. IRA's Sherwood partnership interest was reflected on IRA's books at the end of 1982 as follows:

Opening balance --
Record transactions thru Nov. 1982 $100
Transfer via Administration Co. client 124,900
Reclassify loan to investment 50,000
Adjustment for 1982 loss (89,577)

Account total 85,423

In 1983, IRA invested an additional $150,000 in Sherwood and IRA was allocated a $287,165 loss for the year. IRA's interest in the Sherwood partnership was reflected on the books at the end of 1983 as follows:

Opening balance $85,423
Contribution to partnership 150,000
1983 loss (287,165)

Account total (51,742)

On December 31, 1984, IRA transferred its 50-percent

interest in the Sherwood partnership, 45 percent each to Carlco and TMT and 10 percent to BWK, Inc. As a result, Carlco and TMT each received a 22.5-percent interest in the Sherwood partnership and BWK, Inc., received a 5-percent interest. IRA reported a gain of $51,742 (the excess of the $376,742 of total losses claimed over IRA's total investment of $325,000) on the transfer of its interest in Sherwood and recorded the transfer on its books as follows:

Investment in Sherwood
Opening balance ($51,742)
Gain on distribution of Sherwood 51,742

Account total 0

Investment in Carlco
Rec. gain on dist of Sherw 1

Investment in TMT
Rec. gain on dist of Sherw 1
Investment in BWK, Inc.
Rec. gain on dist of Sherw 1

Adjusting Journal Entry 21
Invest in Sherwood 51,742
Invest in Carlco 1
Invest in BWK 1
Invest in TMT 1

Gain on sale of Pship 51,745

Carlco, TMT, and BWK, Inc., recorded the contribution of the Sherwood partnership as follows:

Carlco TMT BWK, Inc.
--- --- ---
Investment in Sherwood

Opening balance -- -- --
Sherwood Associates $41,400 $41,400 $9,200
Rec. int. Sherwood from IRA 1 1 1
Rec. K-1 activity (119,116) (119,116) (26,470)
--- --- ---
Paid-in Capital (77,715) (77,715) (17,269)

Rec. int. Sherwood from IRA 1 1 1

d. 1984 Distributions to Carlco, TMT, and BWK, Inc. as Reflected on the Books of the Corporations
The transfers of cash to Carlco, TMT, and BWK, Inc., were recorded on the books of the corporations as, respectively, contributions of capital. The distribution of the Essex partnership interest was recorded as paid-in capital of $20,377 each to Carlco and TMT and $4,528 to BWK, Inc. The distribution of the Sherwood partnership interest was recorded as paid-in capital of $1 each to Carlco, TMT, and BWK, Inc. Additionally, a receivable of $148 for the preferred shares of each of Carlco, TMT, and BWK, Inc. was treated as paid-in capital of each corporation. Thus, amounts recorded as additions to capital during 1984 and total paid-in capital at the close of 1984 for each of the corporations were as follows (balance differences are due to rounding):

Item Carlco TMT BWK, Inc.
--- --- --- ---

Cash $1,870,535 $1,870,535 $415,674
Essex distribution (39,971) (39,971) (8,882)
Essex partnership 20,377 20,377 4,528
Sherwood partnership 1 1 1
Receivable 148 148 148
Consent dividend 105,202
--- --- ---
Total 1984 additions 1,851,091 1,956,294 411,470
Paid in capital

Beginning year 7,398 7,398 7,398
---------- ---------- ---------
End year 1,858,489 1,963,691 418,868

4. Flow of Payments by the Five 1985 Through 1989
After IRA transferred money from the Five to Carlco, TMT, and BWK in 1984, the structure in which payments were received from the Five changed. The payments from Essex and Hyatt (through KWJ Partnership) were no longer reported as IRA's income. Carlco, TMT, and BWK became partners of the Essex partnership and formed the KWJ Co. partnership. Hyatt payments were reported as income of KWJ Co. partnership. Accordingly, the payments from the Essex and KWJ Co. partnerships were reported on the respective returns of Carlco, TMT, and BWK at that time, and Carlco, TMT, and BWK were no longer members of the consolidated group of IRA for tax purposes.
a. Zeus 1984 Through 1988
IRA's consolidated returns for 1984 through 1988 reported the following income, net assets, and stockholder equity with respect to Zeus:

1984 1985 1986 1987 1988
--------- --------- --------- --------- ---------

Income
Interest $4,191 $13,639 $6,586 $684 $3,090
Commission 103,500 128,763 -- -- --
Partnership (203,947) (198,310) -- (31,204) (166,802)
--------- --------- --------- --------- ---------
Total Income (96,256) (55,908) 6,586 (30,520) (163,712)
Deductions (217) (727) (4,600) (105) (275)
--------- --------- --------- --------- ---------
Net income (96,473) (56,635) 1,986 (30,625) (163,987)
NOL -- (96,473) (153,108) (151,122) (181,747)
--------- --------- --------- --------- ---------
Taxable (96,473) (153,108) (151,122) (181,747) (345,734)

Assets
Cash 219 855 3,971 3,866 3,591
Loan rec. 871,028 871,028 871,028 871,028 871,028
Partnerships (224,822) (424,040) (424,040) (454,560) (618,272)
Pooled funds 110,091 251,130 -- -- --
Non-mar. sec -- -- 250,000 250,000 250,000
--------- --------- --------- --------- ---------
Total 756,516 698,973 700,959 670,334 506,347
Liabilities -- -- -- -- --
--------- --------- --------- --------- ---------
Net assets 756,516 698,973 700,959 670,334 506,347

Capital stock 100 100 100 100 100
Capital surplus 49,900 49,900 49,900 49,900 49,900
Retained earn. 706,516 648,973 650,959 620,334 456,347

The Frey corporation paid Zeus $103,500 in 1984 and $128,763 in 1985 (totaling $232,263). During 1984, Zeus transferred $5,028 to Holding Co. The transfer increased the Holding Co. receivable from $802,000 owed by Holding Co. at the beginning of the year to $807,028 owed at the end of the year. During 1986, Zeus purchased 25 shares of preferred stock in another Kanter entity called Windy City, Inc. for $250,000. During 1988, Zeus eliminated the HELO receivable in exchange for the following receivables owed to HELO by the parties indicated:

APS Insurance $4,570
Beach Trust 17,651
R Trust 10,000
Softy Trusts 10,600
Grasshopper Trust 16,250
Pamela Osowski 4,929

Total 64,000

Zeus never accrued any interest or received any payments on any of those receivables or the receivables from Holding Co. and HELO.

b. Distributions of Schnitzer-PMS and Essex Payments Made During 1985 Through 1989

During 1985, IRA received funds from Schnitzer-PMS and Essex and made distributions to Carlco, TMT, and BWK, Inc. as follows:

1985 Receipts Distributions
----- -------- ------------

01/15 Qrtly payment $90,423
01/21 Carlco $40,500
TMT 40,500
BWK, Inc. 9,000
Essex-Blng to TMT, etc. 41,800
01/30 Pymt on amts owed re Essex 18,450
18,450
4,100
04/08 Schnitzer Corp./qrtly inst/int balloon 90,423
04/16 Carlco 40,500
TMT 40,500
BWK, Inc. 9,000
04/18 Essex 1st quarter dist. 13,063
04/25 Carlco 5,850
TMT 5,850
BWK, Inc. 1,300
07/03 Schnitzer Corp. qrt. pmt.($10,000 int BA) 90,423
07/08 Essex 2d quarter dist. 36,575
07/11 Carlco 16,200
TMT 16,200
BWK, Inc. 3,600
10/03 Essex 3d quarter 28,738
10/04 Schnitzer Corp.3d quarter 90,423
10/15 Carlco 81,000
TMT 81,000

BWK, Inc. 18,000

IRA recorded the 1985 payments to Carlco ($184,050), TMT ($184,050), and BWK, Inc. ($40,900) as follows (balance differences are due to rounding):

Item Carlco TMT BWK, Inc.
---------- ---------- ---------- ---------

Note to
Beginning -- -- --
07/11 additional $16,200 $16,200 $3,600
04/18 Essex (5,878) (5,878) (1,306)
07/08 Essex (16,459) (16,459) (3,658)
10/03 Essex (12,931) (12,931) (2,874)
12/31 Rec to proper account (16,200) (16,200) (3,600)
12/31 To combine same acct (360) (360) (80)
Ending (35,629) (35,629) (7,917)

Notes payable
Beginning -- -- --
01/13 Pymt on amts owed re Essex 18,450 18,450 4,100
01/21 FM Essex--blngs to TMT etc (18,810) (18,810) (4,180)
12/31 To combine same account 360 360 80
Ending -- -- --

Investment in stock
Beginning 1,856,942 1,962,144 417,321
01/21 additional capital 40,500 40,500 9,000
04/16 additional capital 40,500 40,500 9,000
04/25 additional capital 5,850 5,850 1,300
10/14 additional capital 81,000 81,000 18,000
12/31 R/C to proper account 16,200 16,200 3,600
To record consent dividend 97,206
Ending 2,040,992 2,243,400 458,221

1986

The record does not contain detailed general ledgers for IRA after 1985. The record indicates, however, that IRA recorded the 1986 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Note to			
Beginning	($35,629)	($35,629)	($7,917)
Pd 2/86	35,629	35,629	7,917
Ending	-0-	-0-	-0-

Investment in stock			
Beginning	2,040,992	2,243,400	458,221
Ending	2,203,362	2,488,403	494,303
Contri. consent dividend		82,633	
Cash additions	162,370	162,370	36,082

1987

IRA recorded the 1987 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Note to			
Beginning	--	--	--
08/06/87 Essex 2d quarter	($29,626)	($29,626)	($6,584)
10/08/87 Distr. Essex	29,626	29,626	6,584
12/10/87 Essex 3d quarter	(8,229)	(8,229)	(1,829)
12/15/88 Distr. Essex	8,229	8,229	1,829
Ending	--	--	--

Investment in stock			
Beginning	2,203,362	2,488,403	494,303

Additions			
01/14/87	40,690	40,690	9,042
05/07/87	40,690	40,690	9,042
09/10/87	40,690	40,690	9,042
10/19/87	40,690	40,690	9,043
12/11/87	29,553	29,553	
Total cash contrib.	192,313	192,313	36,169
12/31/87 consent div.		31,960	
Ending	2,395,676	2,712,677	530,473

1988

IRA recorded the 1988 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Investment in stock			
Beginning	$2,395,676	$2,712,677	$530,473
Additions			
02/03/88	40,690	40,690	9,042
05/12/88	40,690	40,690	9,042
08/05/88	40,690	40,690	9,042
12/13/88	40,690	40,690	9,043
Total	162,761	162,761	36,169
2/31/88 consent div.		65,093	
Ending	2,558,437	2,940,531	566,642

1989

IRA recorded the 1989 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Note receivable from			
Beginning	--	--	--

09/14/89 loan $55,000 $35,000 --
09/18/89 void check (55,000) (35,000) --
09/18/89 loan 117,000 44,000 --
12/04/89 loan 5,355 10,274 --
--- ---
Ending 122,355 54,274 --

Notes payable to
Beginning -- -- --
01/11/89 Essex 4th quarter dist. (20,573) (20,573) ($4,572)
01/11/89 Dist. 20,573 20,573 4,572
01/18/89 Dist. 20,573 20,573 --
01/18/89 void check (20,573) (20,573) --
07/26/89 Essex 1 & 2 quarter dist. (15,048) (15,048) (3,344)
08/02/89 Dist. 15,048 14,048 3,344
08/23/89 Essex dist. (8,229) (8,229) (1,829)
08/28/89 Dist. 8,229 8,229 1,829
Ending -- -- --

Investment in stock
Beginning 2,558,437 2,940,531 566,642
Additions
03/20/89 378,190 378,190 84,042
Rcls amended consent dividend from TMT (179,686)
1986-1988
Ending 2,936,627 3,139,035 650,684

c. Loans From IRA to KWJ Partnership Through 1989
In addition to payments made to Carlco, TMT, and BWK, Inc., that were treated as additions to capital, IRA made distributions recorded as loans to KWJ partnership as follows:

Receivable 1985 1986 1987 1988 1989
--- --- --- --- --- ---
Beginning year $30,000 $75,500 $113,500 $161,500 $181,500
Loans during year 45,500 38,000 48,000 20,000 68,370

End year 75,500 113,500 161,500 181,500 249,870

d. Balance Sheets of Carlco, TMT, and BWK, Inc.1983 Through 1989
The balance sheets for Carlco, TMT, and BWK, Inc. for the years 1983 through 1989 were as follows:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
****
****
******** This is piece 1. -- It begins at character 1 of table line 1. ********
****
****
Carlco 1983 1984 1985 1 986 1987
--- --- --- --- --- ---

Assets $7,500 $1,967,188 $2,327,066 $2,699,998 $3,078,545
Liabilities 4,000 4,000
Net assets 7,500 1,967,188 2,323,066 2,699,998 3,074,545

Cap. stock

Common 100 100 100 100 100
Preferred 2 3 3 3 3
Capital 7,398 1,858,489 2,042,539 2,168,127 2,397,222
surplus
Retained 108,596 280,424 531,768 677, 220
earnings
Total equity 7,500 1,967,188 2,323,066 2,699,99 8 3,074,545

Increase in 1,851,091 184,050 125,588 229,095
surplus
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70
****
****
******* This is piece 2. -- It begins at character 71 of table line 1. ********
****
****
1988 1989
--------- ---------

$3,728,530 $4,404,569
122,355
3,728,530 4,282,214

100 100
3 3
2,559,983 2,938,173

1,168,444 1,343,938

3,728,530 4,282,214

162,761 378,190

71..+...80....+...90...

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
****
****
******** This is piece 1. -- It begins at character 1 of table line 1. ********
****
****
TMT 1983 1984 1985 1986 1987
---------- ------ --------- --------- --------- ---------

Assets $7,500 $2,015,911 $2,293,151 $2,518,717 $2,735,965
Liabilities 4,000
Net assets 7,500 2,015,911 2,289,151 2,518,717 2,735,965

Cap. stock
Common 100 100 100 100 100
Preferred 2 3 3 3 3
Capital 7,398 1,963,692 2,244,947 2,489,950 2,714,224
surplus
Retained 52,116 44,101 28,664 21,638
earnings

Total equity 7,500 2,015,911 2,289,151 2,518,71 7 2,735,965

Increase in 1,956,294 281,255 245,003 224,274
surplus

Book income 157,318
Consent 105,202 97,206 82,633 31,960
dividend
Retained 52,116
earnings

Surplus 1,956,294 281,255 245,003 224,274
increase
Consent 105,202 97,206 82,633 31,960
dividend
--------- --------- --------- ---------
Difference 1,851,092 184,049 162,370 192,314
FN* Reverse 86, 87 & 88 consent dividend paid to IRA.
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70
****
****
******* This is piece 2. -- It begins at character 71 of table line 1. ********
****
****
1988 1989
--------- ---------

$3,215,925 $3,880,997
54,274
3,215,925 3,826,723

100 100
3 3
2,942,077 3,140,582

273,745 686,038

3,215,925 3,826,723

227,853 198,505

65,093 -0-

227,853 37 8,190

65,093 *179,786

--------- ---------
--------- ---------
162,760 198,404

71..+...80....+...90...

BWK, Inc. 1983 1984 1985 1986 1987 1988 1989
---------- ------ -------- -------- -------- --------- -------- --------

Assets $7,500 418,558 406,909 388,362 395,808 451,711 515,772
Liabilities 7,534 1,000 286 8,000 -0- 2,253
Net assets 7,500 411,024 405,909 388,076 387,808 451,711
513,519

Cap. stock
Common 100 100 100 100 100 100 100
Preferred 2 3 3 3 3 3 3
Capital 7,398 418,868 459,768 495,869 532,038 568,207 652,250
surplus
Retained (7,947) (53,962) (107,896) (144,333) (116,599)

(138,834)
earnings
Total equity 7,500 411,024 405,909 388,07 6 387,808 451,711
513,519

Incrẽase in 411,470 40,900 36,10 1 36,169 36,169 84,043
surplus

B. Flow of the Funds Paid By the Five Through IRA and Its Subsidiaries to Kanter, Ballard, and Lisle

1. Overview

The payments from the Prudential transactions were distributed by various means either directly to Ballard, Lisle, and Kanter or indirectly through their family members or trusts and other entities established for the benefit of their families. Some distributions were recorded as receivables owed by the person or entity receiving the distribution; others were recorded as consulting fees or director's fees. Distributions from KWJ Corp. and later KWJ partnership to Ballard's and Lisle's children were treated as consulting fees. In 1983, IRA began distributing the funds accumulated from the Prudential transactions to Carlco, TMT, and BWK, Inc. Lisle was given control over the funds in Carlco, Ballard was given control over the funds in TMT, and Kanter was given control over the funds in BWK, Inc. Lisle, Ballard, and Kanter treated the funds as their own and used the funds for their personal benefit.

2. Payments from IRA, KWJ Corp., and KWJ Co. Partnership

a. 1982: IRA Payments to Ballard and Lisle

In 1982, Ballard received $12,500 from IRA as a "director's fee". The check was dated in 1981 but cashed in 1982. On March 2, 1982, IRA paid Lisle $1,157.84.

b. Consulting Fees Paid to Ballard's and Lisle's Children

Melinda Ballard and Karen Ballard Hart were Ballard's daughters. Amy Albrecht was Lisle's daughter, and Thomas Lisle was Lisle's son. In 1982, KWJ Corp. (and later the KWJ partnership) began paying Thomas Lisle, Amy Albrecht, and

Melinda Ballard $1,000 each per month. [FN30] In 1984, the KWJ partnership began paying Karen Hart $1,000 each month. The payments continued until at least 1989. From 1982, KWJ Corp. and the KWJ partnership paid the Lisle and Ballard children the following amounts as consulting fees: [FN31]

	Lisle Children		Ballard Children	
Year	Thomas Lisle	Amy Albrecht	Melinda Ballard	Karen Hart
1982	$7,000	$7,000	$7,000	--
1983	12,000	12,000	12,000	--
1984	12,000	12,000	12,000	$2,000
1985	12,000	11,000	12,000	12,000
1986	12,000	13,000	12,000	12,000
1987	12,000	12,000	12,000	12,000
1988	12,000	12,000	12,000	12,000

During 1989, KWJ partnership paid the Lisle and the Ballard children $36,000. Of the $36,000 paid, Lisle's children received at least $18,000 and Ballard's children received at least $12,000. [FN32]

None of the Ballard or the Lisle children performed any services for KWJ Corp. or KWJ partnership. The Hyatt payments and interest were the only sources of income KWJ Corp. or KWJ partnership ever received.

In February 1990, after the Internal Revenue Service began examining Ballard's, Kanter's, and Lisle's returns for the years at issue, Kanter sent letters to the children terminating KWJ Co's. "consulting arrangement" with them. In the letters Kanter stated that the children had done nothing for a number of years.

c. KWJ Partnership 1989 Payments to Lisle and Ballard

As noted earlier, Carlco, TMT, and BWK, Inc., organized the KWJ Partnership. The Hyatt payments were issued by Hyatt

to Weaver who forwarded the payments to the KWJ Partnership, out of which Weaver was paid his 30 percent and the balance was distributed to Carlco, TMT, and BWK, Inc.

On August 2, 1989, IRA issued checks in the amount of $22,618.80 each to Ballard and Lisle. After the checks were issued to Ballard and Lisle, IRA records reflected a transfer of $45,237 to "KWJ Company" on August 8, 1989. Also on August 8, 1989, ledger entries reflected that the check to Lisle for $22,618.80 was "void". Another ledger entry, on August 15, 1989, reflected that the check to Ballard for $22,618.80 was "void". Despite the fact that IRA's ledger entries stated that these checks were void, Lisle's 1989 return reflected that he received this money and that the check was not "voided." Lisle reported the $22,619 on his return as income from the "KJW [sic] Company."

3. Disposition of Funds out of Carlco, TMT, and BWK to Kanter

a. Creation of Carlco, TMT, and BWK, Inc.

The certificates of incorporation of Carlco, TMT, and BWK, Inc., authorized each corporation to issue 1,000 shares of 10-cent par value common stock. Certificates of amendment for each corporation were filed in December 1983. The amended certificates authorized the corporations to issue 11,000 shares of stock comprised of 10,000 shares of 1-cent par value preferred stock and 1,000 shares of 10-cent par value common stock. The amended certificates granted each corporation's board of directors authority to fix the dividend rights, dividend rate, conversion rights, voting rights, the rights and terms of redemption (including sinking fund provisions), the redemption price or prices, and the liquidations preferences of the preferred shares. The record does not contain copies of any resolutions by the board of directors of any of the three corporations setting preferences or limitations on the preferred stock.

Kanter was a beneficiary of a trust called the Morkan Trust. [FN33] On October 17, 1983, Kanter exercised a power of appointment over the Morkan Trust to form the Christie and

Orient Trusts. Sharon Meyers was named as trustee of the Christie and Orient Trusts. Members of Lisle's family were named as beneficiaries of the Christie Trust, and members of Ballard's family were named as beneficiaries of the Orient Trust.

In December 1983, IRA acquired 1,000 shares (100 percent) of the common stock of each of Carlco, Inc. (Carlco), TMT, Inc. (TMT), and BWK, Inc. (BWK). IRA paid $6,000 to each of the corporations for the shares of stock. Also in December 1983, Carlco, TMT, and BWK each issued 150 shares of preferred stock for $1,500. Carlco preferred shares were issued to the Christie Trust (Lisle's family trust); TMT preferred shares were issued to the Orient Trust (Ballard's family trust); BWK preferred shares were issued to the BK Children's Trust, the beneficiaries of which were members of Kanter's family.

In January 1984, Carlco, TMT, and BWK each issued 150 additional shares of preferred stock for $150. Carlco issued the additional preferred shares to the Christie Trust, TMT issued the additional preferred shares to the Orient Trust, and BWK issued the additional preferred shares to the BK Children's Trust. As a result of those trusts' ownership of these preferred shares, Carlco, TMT, and BWK, Inc., no longer qualified as members of IRA's consolidated group of corporations and were not included in the consolidated tax returns IRA filed.

b. Control and Management of Carlco, TMT, and BWK, Inc.

Kanter directed Freeman (IRA's president) to distribute funds received by IRA related to Prudential transactions in the ratio of 45 percent to Carlco, 45 percent to TMT, and 10 percent to BWK. From 1984 through 1989, IRA generally transferred funds and other assets to Carlco, TMT, and BWK, Inc., in the respective 45-45-10 allocation ratio Kanter had directed.

Lisle managed and controlled Carlco's investments. Lisle and members of his family, including his wife Donna Lisle and his son Thomas Lisle, had signatory authority over Carlco's accounts. In 1982 Kanter, his brother Carl Kanter,

and Meyers were the officers and/or directors of Carlco. In 1983, Meyers and Freeman were the directors, president, and treasurer, and Gallenberger was secretary. From 1984 through 1989, there were no directors listed; Lisle, his brother Henry Lisle, his son Thomas Lisle, and his wife Donna Lisle served as president or vice president, D. Dubanevich was secretary; and, except for 1985, [FN34] Meyers or Gallenberger was treasurer.

Ballard managed and controlled TMT's investments. Ballard and members of his family, including his wife Mary Ballard, had signatory authority over TMT's accounts. In 1982, Kanter, his son Joshua, and Meyers were the directors of TMT, Kanter was president, his son Joshua was treasurer, and Meyers was vice president and secretary. Between 1983 and 1989, Freeman, Meyers, and/or Gallenberger were the directors and officers.

Kanter managed and controlled BWK, Inc.'s investments. In 1982, Kanter, his son Joshua, and Meyers were the directors and officers of BWK, Inc. From 1983 through 1989, Weisgal was the sole director and president, Kanter, Meyers, and/or Gallenberger were the remaining officers. [FN35] In 1990, Kanter was the sole director and president, and Gallenberger was secretary.

After Carlco, TMT, and BWK, Inc., were organized, the payments by the Five were distributed to Carlco, TMT, and BWK, Inc.

c. Ballard: Disposition of Funds out of TMT

During the years 1982 through 1989, the following individuals were listed as the "officers" and "directors" of TMT:

Title 1982 1983 1984
---------- -------- -------- --------
Directors Kanter Freeman Freeman
Joshua Kanter Meyers Meyers
Meyers
President Kanter Meyers Meyers
Vice president Meyers

Vice president Meyers
Secretary Meyers Gallenberger Gallenberger
Treasurer Joshua Kanter Meyers Meyers
Assistants Joshua Kanter

Title 1985 1986 1987
---------- ---------- ---------- ----------
Directors Meyers Gallenberger Gallenberger
President Meyers Gallenberger Gallenberger
Vice president
Secretary Gallenberger Gallenberger Gallenberger
Treasurer Meyers Gallenberger Gallenberger
Assistants

Title 1988 1989
---------- ---------- ----------
Directors Gallenberger Gallenberger
President Gallenberger Gallenberger
Vice president
Secretary Gallenberger Gallenberger
Treasurer
Assistants

The records for TMT were maintained at Ballard's home. TMT's business address was the same as Ballard's residence in Seabright, New Jersey. Mail for TMT was received at Ballard's home. Correspondence from TMT was sent from Ballard's home address.

i. TMT Accounts

During 1984, IRA transferred over $1 million to TMT. The money generally was deposited into TMT's account with the Administration Co., and certificates of deposit (CD's) were purchased through Administration Co.'s account at the American National Bank in Chicago.

At the end of 1984, the money designated for TMT in CD's at the American National Bank in Chicago, purchased through the Administration Co. account, totaled $1,604,000. By the

end of the year 1985, no money designated for TMT was in CD's at the American National Bank in Chicago. The money that had been in CD's at the American National Bank in Chicago was transferred into CD's at the Wells Fargo Bank in San Francisco. By the end of the year 1985, the amount of money in CD's at the Wells Fargo Bank San Francisco totaled $1,874,295.

During the years 1984 through 1989, moneys other than CD's for TMT were deposited in an account maintained at the Wells Fargo Bank, in San Francisco, account No. 170-752. The mailing address of this account was 65 Island View Townhouses, Seabright, New Jersey, which was the Ballard residence address. Ballard opened this account in the name of "TMT", and he and his wife had signatory authority over it. The money in this account at the end of the years 1984 through 1989 was as follows:

Year	Wells Fargo
1984	--
1985	$8,768
1986	19,438
1987	157,489
1988	192,915
1989	141,968

By the end of the year 1986, the amount of money in CD's at the Wells Fargo Bank decreased to zero. Of the money that had been in CD's, $1,205,900 had been transferred to a Goldman Sachs brokerage account. The money in the Goldman Sachs brokerage account at the end of the years 1987 through 1989 was as follows:

Year	Goldman Sachs
1987	$53,803
1988	75,460

1989	155,300

During the years 1986 through 1989, moneys for TMT were deposited in an account maintained at the Citizen Bank. The balance in this account at the end of the years 1986 through 1989 was as follows:

Year	Citizen Bank
1986	$25,248
1987	26,600
1988	1,929
1989	2,023

TMT also had a money market account (Kemper Money Market account). At the end of the year 1989, there was a balance of $349,182 in the Kemper Money Market account.

ii. "Loans" From TMT

In 1984 receivables owed by Ballard's Seabright Trust and Seabright Corp. respectively in the amounts of $12,255 and $31,440 were transferred from Administration Co. to TMT. From 1984 through 1989, the Seabright Trust and Seabright Corp. received additional "loans" totaling $132,980 from TMT. The balances on these loans at the end of each year were as follows:

Year	Seabright Trust	Seabright Increase	Corp.	Increase
Trans. from Special E	$12,255	--	$31,440	--
1984	53,055	$40,800	31,440	--
1985	79,155	26,100	31,520	$80
1986	100,155	21,000	36,520	5,000
1987	100,155	--	41,520	5,000
1988	135,155	35,000	41,520	--
1989	135,155	--	41,520	--

Total 122,900 10,080

There were no notes in connection with the "loans" to the Seabright Trust or the Seabright Corp. There is no evidence that either the Seabright Trust or Seabright Corporation paid interest on the "loans" from TMT. The loans were never repaid.
From 1984 through 1989, Claude Ballard and Mary Ballard received a total of $303,943 from TMT as "loans". The balances due on these loans at the end of each year were as follows:

Year	Claude Ballard	Mary Ballard
1984	$10,599	--
1985	10,599	$160,000
1986	16,599	160,000
1987	36,943	160,000
1988	136,943	160,000
1989	146,943	160,000

With respect to the $160,000 "loan" to Mary Ballard, during 1985, a document dated December 26, 1986, purported to provide for the repayment of this "loan" with Macy's stock held privately by Ballard. The records of TMT do not indicate that the $160,000 "loan" was repaid. The records of TMT do not indicate that the Macy's stock was given to TMT in accordance with the December 26, 1986, document.
In 1986, $100,000 of TMT funds were used to purchase land described in the TMT general Ledger as "St. Francis Arkansas--Land ." The cost of this land was $100,000. In 1987, this property was transferred to Ballard. Book entries were made to reflect this transaction. "Loans" to Ballard were increased by $100,000. The land was no longer reflected as a TMT asset. The adjusting journal entry that went with the transfer to Ballard described the property as the "Fairfield Planting Company". This "loan" has never been repaid. In

1987, TMT paid an additional $20,344 for the Fairfield property, which amount was treated as an additional loan to Ballard.
The Fairfield Planting Co. is an S corporation which owned the Fairfield Plantation, a farm in Arkansas. The income and loss from the Fairfield Plantation Co. were reported on Ballard's 1987, 1988, and 1989 returns.
At the time of trial of these cases, TMT owned the following farms or other entities: Ashland Plantation in Mississippi, Fairfield in Arkansas, and Loch Leven in Mississippi. The Ballards referred to the Loch Leven farm as "our big farm." According to Mary Ballard, TMT, at one time, had been involved with Lock Leven, but it was owned by the Ballards. Mrs. Ballard did not know who owned the stock of TMT. She referred to TMT as her husband's business.
Ficom was a sole proprietorship formed by Ballard's daughter Melinda Ballard in 1983. In 1986, $4,000 from TMT was transferred to Ficom. In 1988, TMT transferred another $15,000 to Ficom. When the transfer was made, a bookkeeping notation was also made to write off the investment in 1989. The investment in Ficom was subsequently written off as worthless in 1989.
d. Lisle: Disposition of Funds out of Carlco
During the years 1982 through 1989, the following individuals were listed as the "officers" and "directors" of Carlco:

Title	1982	1983	1984
Directors	Kanter	Freeman	(deleted)
	Carl Kanter	Meyers	
President	Carl Kanter	Meyers	Henry Lisle
Vice president	Kanter	_____	Donna Lisle
Secretary	Meyers	Gallenberger	D. Dubanevich
Treasurer	Meyers	Meyers	Meyers

Title	1985	1986	1987

Directors	None	None	None
President	Henry Lisle	Henry Lisle	Henry Lisle
Vice president	Donna Lisle	Donna Lisle	Donna Lisle
Secretary	Dubanevich	Dubanevich	Dubanevich
Treasurer	_____	Gallenberger	Gallenberger
Assistants	Meyers	Lisle	Lisle

Title	1988	1989
Directors	None	None
President	Henry Lisle	Robert Lisle
Vice president	Donna Lisle	Thomas Lisle
Secretary	Dubanevich	Donna Lisle
Treasurer	Gallenberger	Gallenberger

During the years 1984 through 1989, moneys from Carlco were deposited in a brokerage account maintained at Goldman Sachs (Carlco Goldman Sachs account). The mailing address of the Carlco Goldman Sachs account was in care of Robert Lisle, 47 Cheltenham Way, Avon, Connecticut, which was the address of the Lisle family residence. Lisle, Mrs. Lisle, and Henry Lisle (Lisle's brother) had signatory authority over this account. The balance in this account at the end of 1984 to 1988 was as follows:

Year	Goldman Sachs
1984	$113,255
1985	42,362
1986	90,601
1987	70,372
1988	392,252
1989	82,559

During the years 1984 through 1989, other money from Carlco was deposited into an account in the name of Carlco

at the Hartford Bank in Connecticut (Hartford account). The mailing address of the Hartford account was in care of Lisle at the Lisle family residence. Lisle and his wife had signatory authority over the account. The balance in the account at the end of the years 1984 through 1988 was as follows:

Year	Hartford
1984	$18,198
1985	10,871
1986	211,618
1987	161,573
1988	153,767

On April 12, 1985, Lisle withdrew $3,000 from Carlco's Hartford account to pay a receivable owed to Administration Co. by his grantor trust, the RWL Cinema Trust. The payment did not create a receivable owed to Carlco by RWL Cinema Trust.

Around 1989, the Lisles moved to Dallas, Texas. During the year 1989, money from Carlco was deposited in an account maintained at the North Dallas Bank, Dallas, Texas (North Dallas account). The mailing address of the North Dallas account was 5519 Bent Trial, Dallas, Texas, which was the address of the Lisles' Dallas residence. Lisle and his wife had signatory authority over the North Dallas account. At the end of 1989 there was $123,323 in the account.

e. Kanter: Disposition of Funds out of BWK, Inc.

During the years 1984 through 1989, Kanter and his son, Joshua Kanter, received a "salary" from BWK, Inc., in the amounts indicated:

Year	Burton Kanter	Joshua Kanter
1984	$40,000	–
1985	40,000	$9,000
1986	40,000	13,000

1987 30,000 4,000
1988 30,000 --
1989 30,000 --
---------- ----------
Total 210,000 26,000

On April 11, 1985, $400,000 was transferred from BWK, Inc. to Kanter. The transfer was recorded on BWK, Inc.'s books as a receivable owed by Kanter. Beginning in 1988, although book entries continued to show that BWK, Inc., paid Kanter a $30,000 salary, Kanter did not receive the money. Instead, BWK, Inc., reduced the $400,000 receivable from Kanter by $30,000 per year.

4. Loans

a. IRA Loans to Kanter

IRA's records reflect the following amounts transferred to Kanter and recorded as receivables:

Burton W. Kanter

1982 Beginning balance --
Adj for bal in Cedilla Trust $4,450
Ending balance 4,450

1983 Beginning balance 4,450
Loan repymt. from BWK --
Ending balance

1984 No entry

1985 Beg. balance --
Sold Geochem to BWK 500
Sell TWOOD rec to BWK 10,000
Sold funds for Energy 5,000
Rec sale of assets sold 1,110
Ending balance 16,610

1986 Unexplained acct. total (39,940)

1987 Beg. balance (39,940)
Repay BWK RE H BLUM 219
HB Rpymt (S/B to BWK) (219)
Move to notes payable 39,940
Ending balance --

1988 No entry

1989 Beg. balance --
B. Kanter/Ln 250,000
Unavailable history 350,000
Ending balance 600,000

b. Loans to Ballard, Lisle, Their Family Members and Trusts

Ballard and Lisle established the following grantor trusts, the income (or losses) of which was includable in Ballard's and Lisle's income pursuant to sections 671 through 678:

Date Established Ballard Lisle
---------- ---------- ----------

10/23/73 CMB Cinema Trust [FN36] RWL Cinema Trust
7/15/75 CMB Cinema Trust II RWL Cinema Trust II
6/03/80 Summit Trust Basking Ridge Trust
11/02/81 Seabright Trust

Mrs. Lisle and/or Lisle's children or descendants were the beneficiaries of Lisle's grantor trusts, and Kanter and/or Weisgal were the trustees. Mrs. Ballard and/or Ballard's children were the beneficiaries of Ballard's grantor trusts, and Kanter and/or Weisgal were the trustees.

The CMB Cinema Trust and CMB Cinema Trust II, RWL Cinema Trust, and RWL Cinema Trust II (hereinafter collectively referred to as the Cinema trusts) each made

investments, as limited partners, in certain movie shelter partnerships. Each trust financed the acquisition of its movie partnership interest through loans from IRA and Int'l Films. The Seabright Corp. was owned by the Mary Family Trust. The Seabright Corp. owned a farm called Seabright Farm located near Little Rock, Arkansas. The beneficiaries of the Mary Family Trust were Mary Ballard and her three daughters. The records of the Seabright Corp. were maintained at Ballard's residence. Mary Ballard was an officer of the Seabright Corp.

On May 29, 1976, the CMB Cinema Venture partnership was formed. The CMB Cinema Trust and the CMB Cinema Trust II were partners in the CMB Cinema Venture partnership. As of the end of 1987, CMB Cinema Venture partnership was a shareholder of Int'l Films.

The movie ventures in which the trusts invested proved unsuccessful and were not profitable. Substantial losses from the ventures were reported by Ballard on his income tax returns. The Internal Revenue Service later disallowed the deductions that Ballard claimed on his tax returns with respect to these movie investments. As a result, the Ballards were required to pay additional taxes. In July 1985, Mrs. Ballard borrowed $160,000 from TMT to pay this income tax liability.

Kanter entities made the following loans to Ballard, his family members, and entities established for the benefit of his family members:

Ballard Loans

Lender Year Distributee Amount

Int'l Films 1974 CMB Cinema Trust $10,000
Int'l Films 1975 CMB Cinema Trust 21,500
Int'l Films 1975 CMB Cinema Trust II 12,500

Int'l Films 1976 CMB Cinema Trust 8,200
Int'l Films 1976 CMB Cinema Trust 19,000
Int'l Films 1976 CMB Cinema Trust II 1,100
Int'l Films 1977 CMB Cinema Trust 2,200
Int'l Films 1977 CMB Cinema Trust II 3,400
Int'l Films 1978 CMB Cinema Trust 3,000
Int'l Films 1978 Ballard 9,500
Int'l Films 1979 Ballard 8,784
HELO 1980 Summit Trust 85,000
HELO 1981 Summit Trust 20,700
Int'l Films 1981 CMB Cinema Trust 4,000
IRA 1982 Ballard 160,400
IRA 1983 Ballard 500
Administration Co. 1983 Seabright Trust 11,300
Administration Co. 1984 Ballard 10,000
Administration Co. 1984 Seabright Corp. 25,840
TMT 1985 Mary Ballard 160,000
Administration Co. 1988 Seabright Corp. 5,000

Kanter entities made the following loans to Lisle, his family members, and entities established for the benefit of his family members:

Lisle Loans

Lender Year Distributee Amount

Int'l Films 1974 RWL Cinema Trust $15,000
Int'l Films 1975 RWL Cinema Trust II 20,000
Int'l Films 1975 Lisle 10,000
Int'l Films 1976 RWL Cinema Trust 5,000
Int'l Films 1976 RWL Cinema Trust II 18,000
Int'l Films 1977 RWL Cinema Trust II 5,000
Int'l Films 1978 Lisle 9,500
Int'l Films 1978 RWL Cinema Trust II 3,750

Int'l Films 1978 RWL Cinema Trust II 4,469
Int'l Films 1979 Lisle 8,784
Int'l Films 1979 RWL Cinema Trust II 3,000
Int'l Films 1980 RWL Cinema Trust II 250
Int'l Films 1981 RWL Cinema Trust II 2,750
Int'l Films 1982 RWL Cinema Trust II 2,320
Int'l Films 1983 RWL Cinema Trust II 3,000
HELO 1983 Basking Ridge Trust 95,000
IRA/Int'l Films 1983 Lisle 3,000
Int'l Films 1984 RWL Cinema Trust II 3,000
Administration Co. 1985 RWL Cinema Trust II 3,000
Int'l Films 1986 RWL Cinema Trust II 3,000
Administration Co. 1987 RWL Cinema Trust II 2,463
IRA 1988 RWL Cinema Trust II 6,000
BWK 1989 RWL Cinema Trust II 3,000
BWK 1990 RWL Cinema Trust II 2,969

5. Writeoff of Loans and Losses

Kanter traded receivables between various entities and used convoluted bookkeeping entries to eliminate the receivables and to create bad debt and worthless stock deductions.

IRA distributed $160,400 to Ballard in 1982 and $500 in 1983 and recorded the transfers as receivables owed by Ballard. IRA immediately transferred the receivables to Int'l Films. IRA's general ledgers reflected Ballard's receivable account for 1982 and 1983 as follows:

Claude Ballard

1982 Beg. balance
Record trns Dec 1982 $160,400
Asgn Ballard ln to IFI (160,400)
Ending balance -0-

1983 Beg. balance -0-
TACI E ln for C. Ballard 500

Asgn to IFI ck 1120 (500)
Ending balance -0-

IRA's general ledger showed Int'l Films' receivable for 1982 as follows:

Int'l Films

1982 Beg. balance $70,200
Int'l Films 13,000
Int'l Films 4,000
Int'l Films-loan 1,250
Trans. thru Nov. 1982 7,130
Trans. thru Dec. 1982 5,465
Ballard loan asgn to Int'l Films 160,400

Ending balance 261,445

By the end of 1982, IRA had transferred $1,189,900 to HELO that was recorded as a receivable owed to IRA by HELO. [FN37] In 1983 HELO had $95,000 receivables owed to it from Lisle's Basking Ridge Trust and $106,200 from Ballard's Summit Trust. [FN38]

In 1983, a transaction took place between IRA, the Bea Ritch Trusts, Int'l Films, and HELO which had the effect of (1) increasing the receivables due to IRA from the Bea Ritch Trusts by $500,000; (2) decreasing IRA's outstanding receivables due from HELO by $701,200; (3) eliminating HELO's $95,000 receivables from Lisle's Basking Ridge Trust and $106,200 from Ballard's Summit Trust; and (4) creating IRA receivables of $95,000 from the Basking Ridge Trusts and $106,200 from the Summit Trust. IRA's general ledger and adjusting journal entries reflected the effect of the transfers on receivables owed to it as follows:

HELO Receivables Owed to IRA

1983 Beginning balance $1,189,900
Loan repymt from HELO (11,200)
Part. loan repymt HELO (900)
Repayment frm HELO via BRT 1 (500,000)
Lns Bask Rg & Summit via HELO (201,200)
Ln fm FIN Acq. via HELO 33,500
Ending balance 510,100
FN1. No actual payment was made. Instead the receivable due from Bea Ritch
Trusts was increased by $500,000.

Summit Trust Receivables Owed to IRA

1983 Beg. balance -0-
Ln rpymt from Summit ($10,100)
Lns BSK RG & SMT via HELO 106,200
Asgn SMT & BSK RG to IFI (96,100)
Ending balance -0-

Basking Ridge Trust Receivables Owed to IRA

1983 Beg. balance -0-
Ln rpymt Frm Bask Rdg ($10,300)
Lns BSK RG & SMt via HELO 95,000
Asgn SMT & BSK RT to IFI (84,700)
Ending balance -0-

1983 AJE 9--To adj. for loans made to Basking Ridge & Summit via HELO (remove HELO from middle)

Debit Credit

------- --------
1191-0256 Due from Basking Ridge 95,000
1191-0255 Due from Summit 106,200
1191-032 Due to HELO (201,200)

1983 AJE 26 To record transfer of receivables from Basking Ridge & Summit to IFI on 10/31/83)

Debit Credit
------- --------
1191-0121 Due from IFI 180,800
1191-0255 Due from Summit (96,100)
1191-0256 Due from Basking Ridge (84,700)

Int'l Films Receivables Owed to IRA

1983 Beg. balance 261,445
Loan to Int'l Films 1,400
Loan to Int'l Films 1,000
IFloan on behalf of R Lisle 3,000
Loan to Int'l Films 100
Loan to Int'l Film 200
Loan to Int'l Film 100
Loan repymt from Int'l Films (1,000)
Loan repymt from Int'l Films (500)
Loan repymt from Int'l Films (325)
Loan repymt from Int'l Films (700)
Asgn. to Int'l Films 1 500
Asgn Summit and Basking Ridge Int'l Films 2 180,800
Asgn 1984 Devlp to Int'l Films 3 86,400

Acct. Total 532,420
FN1. Check # 1120--Administration Co. loan for C. Ballard $500.

FN2. 1983 AJE 26--to record transfer of receivables from Basking Ridge & Summit
to Int'l Films on 10/31/83.
FN3. 1983 AJE 28--to record assignment of interest in 1984 Development to Int'l
Films on 10/31/83.

In essence, IRA obtained HELO's receivable due from Basking Ridge and Summit. Simultaneously with this book entry transaction, IRA transferred to Int'l Films the $180,800 balance of the receivables due from Basking Ridge and Summit that it had just obtained from HELO and in exchange, IRA entered on its books a receivable due from Int'l Films for the amount of the Summit and Basking Ridge receivables, $180,800, $201,200 less a credit of $10,300 that was treated as a "loan repayment" from Basking Ridge, and $10,100 credit for a "loan repayment" from Summit. The sources of the credits are not shown in the record. In addition to the receivables, IRA transferred to Int'l Films its interest in a partnership called 1984 Development valued at $86,420.
In 1987, receivables were again reshuffled. On December 17, 1987, Int'l Films' records reflected receivables owing by Ballard, Lisle, and their trusts totaling $582,682, as shown here:

Int'l Films Receivables
Ballard $35,784
Ballard 160,900
CMB Cinema 70,650
CMB II 16,675
Summit 96,100
CMB Cinema Ventures 250

Subtotal 380,359
Lisle 28,284
RWL Cinema 21,500

RWL II 67,839
Basking Ridge 84,700

Subtotal 202,323
Total 582,682

On December 17, 1987, Int'l Films had additional receivables totaling $538,243 owing by the following entities in the amounts shown:

Entity/Individual Amount
Safari Trust $98,450
HGA Cinema 133,695
Elk Invest. 76,500
Inter Alia 125,000
Hargen 8,000
Holding Co. 29,500
Abernathy 67,098

Total 538,243

Although the record does not contain a complete history of the outstanding receivables, the record does disclose the following loans made by Int'l Films through April 1981:

Inter Alia Investments
10/26/73 $140,000
12/16/77 Principal payment (10,000)
B5 03/27/78 Principal payment (5,000)

Balance 125,000

Elk Investment
11/09/76 76,500

Claude M. Ballard
07/27/78 9,500

08/14/79 8,784

Balance 18,284

CMB Cinema Trust
10/29/74 10,000
12/23/75 21,500
04/12/76 8,200
05/27/76 19,000
12/16/77 2,200
11/01/78 3,000
04/81/81 4,000

Balance 67,900

CMB Cinema Trust II
09/29/75 12,500
08/25/76 1,100
12/16/77 3,400

Balance 17,000

Robert W. Lisle
10/31/75 10,000
07/27/78 9,500
03/14/79 8,784

Balance 28,284
RWL Cinema Trust
10/29/74 15,000
05/27/76 5,000

Balance 20,000

RWL Cinema Trust II
11/25/75 20,000
04/12/76 18,000

12/16/77 5,000
11/01/78 3,750
03/28/78 4,469
01/04/79 3,000
02/07/80 250
02/23/81 2,750

Balance 57,219

HGA Cinema Trust
12/23/75 52,200
04/12/76 17,000
05/27/76 37,125
03/14/79 5,000
11/08/79 3,500
01/08/80 100

Balance 114,925
Safari Trusts
12/23/75 33,800
06/15/76 64,000

Balance 97,800
Hargen

07/27/76 8,000

Harold G. Abernathy (stockholder)
05/10/74 45,000
09/11/74 20,000
01/06/75 40,000
Dividend
08/31/74 (11,238)
08/31/75 (7,878)
08/31/76 (18,786)

Balance 67,098

Although some of the receivables indicated an interest rate, there is no evidence that any interest was ever paid, and the outstanding balances were never increased to reflect accruing interest.
In 1987, IRA held 1,500 shares of stock in Int'l Films. IRA's basis in the Int'l Films stock was $65,000. Additionally, in 1987, IRA had a $507,648 receivable owing to it by Int'l Films.
Int'l Films' trial balance sheet for the taxable year ending 8/31/87 showed the following:

Assets

Receivables
Safari Trust $98,450
CMB Cinema Trust 70,650
CMB Cinema Trust II 16,675
RWL Cinema Trust 21,500
RWL Cinema Trust II 67,839
HGA Cinema Trust 133,695
Elk Investment 76,500
Inter Alia 125,000
Hargen 8,000
HELO 1 180,800
Ballard 35,784
Ballard II 160,900
Lisle 28,284
HGA Cinema Trust 67,098
CMB Cinema Venture 250
Holding Co. 29,500

Total receivables 1,120,925
Other assets
1984 Development Partnership 55,288
Other taxes 80

Total assets 1,176,293
Liabilities

Cash deficit 60
IRA 507,648
I & F Corp. 774

Total liabilities 508,482
Stockholder equity

Preferred 150
Common 606
Paid-in capital 655,889
Retained earnings 11,167

Total equity 667,812
FN1. Int'l Films received the HELO receivable in exchange for the Summit Trust
receivable of $96,100 and Basking Ridge Trust receivable of $84,700.

IRA advanced $60 to cover Int'l Films' cash deficit and increased the receivable owed by Int'l Films from $507,648 to $507,708. On December 17, 1987, IRA canceled the $507,708 receivable due from Int'l Films in exchange for (1) the interest in 1984 Development partnership valued at $55,288 [FN39] plus (2) $1,120,925 of receivables. IRA had transferred the interest in 1984 Development partnership to Int'l Films in 1983. Thus the notes and partnership interest that Int'l Films transferred to IRA constituted all of Int'l Films' assets.
IRA apportioned the $507,708 basis in the Int'l Films receivable among the receivables transferred to IRA from Int'l Films and the interest in the 1984 Development, Ltd., partnership interest as follows (balance differences are due to rounding):

Basis Weighted Basis Int'l Films Receivable Int'l Films Average IRA Writeo ff
Safari $98,450 8.37 $42,495 $55,955
CMB Cinema 70,650 6.01 30,513 40,137
CMB Cinema II 16,675 1.42 7,209 9,466
RWL Cinema 21,500 1.83 9,291 12,209
RWL Cinema II 67,839 5.77 29,295 38,544
HGA Cinema 133,695 11.37 57,726 75,969
Elk Invest. 76,500 6.50 33,001 43,499
Inter Alia 125,000 10.63 53,969 71,031
Hargen 8,000 0.68 3,452 4,548
HELO 180,800 15.37 78,035 102,765
Ballard 196,684 16.72 84,889 111,795
Lisle 28,284 2.40 12,185 16,099
Abernathy 67,098 5.70 28,939 38,159
CMB Cin. Vent. 250 0.02 102 148
Holding Co. 29,500 2.51 12,743 16,757
1984 Pship. 55,288 4.70 23,862 31,426
Total 1,176,213 100 507,706 668,507

IRA immediately sold the partnership interest in 1984 Development, Ltd., for $1,000 and 10 of the notes (HELO, Safari, CMB Cinema Trust, CMB Cinema Trust II, RWL Cinema Trust, RWL Cinema Trust II, HGA Cinema Trust, Elk Investment Partnership, Inter Alia, and Hargen) for $1 each to another Kanter entity, MAF, Inc. (MAF), [FN40] and IRA claimed capital losses on the sale or exchange of such notes.

As reflected by a memorandum dated July 17, 1987, Freeman (IRA's president) and Gallenberger agreed that the loans IRA was holding that had been made to Ballard and Lisle, individually, and to their respective grantor trusts would be "forgiven". IRA claimed bad debt deductions with respect to the Ballard notes, the Lisle note, and the Abernathy note.

IRA's worksheet reflects all of the 1984 sales by IRA of these various interest and accounts as set forth in the following table:

IRA Worksheet	Sale Price	Basis Loss on Average Sale
Safari	$1	$42,495 $42,494
CMB Cinema	1	30,513 30,512
CMB Cinema II	1	7,209 7,208
RWL Cinema	1	9,291 9,290
RWL Cinema II	1	29,295 29,294
HGA Cinema	1	57,726 57,725
Elk Invest.	1	33,001 33,000
Inter Alia	1	53,969 53,968
Hargen	1	3,452 3,451
HELO	1	78,035 78,034
	10	344,990 334,978
1984 Develop.	1,000	23,862 22,862
	1,010	368,850 367,840
Ballard		84,888 84,888
Lisle		12,185 12,185
Abernathy		28,939 28,939
		126,012 126,012
CMB Cinema Vent.		102
Holding Co.		12,743
		12,845

Total 507,708 493,852

On December 31, 1987, IRA sold its Int'l Films stock to Gallenberger for $1. In addition to receiving the Int'l Films stock, Gallenberger was also given $3,000. As a result of the transactions, IRA claimed the following losses on its 1987 return: (1) A $65,000 long-term capital loss on 1,500 shares of Int'l Film stock acquired October 2, 1976, with a basis of $65,000 and sold for a price of $zero; (2) a $22,862 long-term capital loss on its investment in 1984 Development, Ltd., partnership interest acquired in 1982 having an adjusted basis of $23,962 and a selling price of $1,000; (3) a $132,013 bad debt; (4) a $1,176,670 loss on business notes.
The IRA general ledger for January 1 to December 31, 1987, shows the following transactions with respect to the receivables:

Holding Co.
Unavailable history $64,000
Assets from Int'l Films ADJ 12 12,743

New balance 76,743

Int'l Films
Unavailable history 507,648
Int'l Films/loan 10/20/87 60
Payment from Int'l Films AJE 08 (507,708)

New balance 0

HELO
Unavailable history 485,825
Sell N/R to MAF ADJ 32 (485,825)
Payment from Int'l Films ADJ 08 114,870
Sold to MAF ADJ 09 (114,870)
Int'l Films on amts owed ADJ 10 (7,433)
MAF purchase HELO N/R (1)

Assets from Int'l Films ADJ 12 7,433
ADJ CR ADJ 24 1

New balance 0

Safari Trust
Payment from Int'l Films ADJ 08 62,550
Sold to MAF ADJ 09 (62,550)
Int'l Films on amts owed ADJ 10 (4,048)
Assets from Int'l Films ADJ 12 4,048

New balance 0

CMB Cinema Trust
Payment from Int'l Films ADJ 08 44,887
Sold to MAF ADJ 09 (44,887)
Int'l Films on amts owed ADJ 10 (2,905)
Assets from Int'l Films ADJ 12 2,905

New balance 0

CMB Cinema Trust II
Payment from Int'l Films ADJ 08 10,594
Sold to MAF ADJ 09 (10,594)
Int'l Films on amts owed ADJ 10 (686)
Assets from Int'l Films ADJ 12 686

New balance 0

RWL Cinema Trust
Payment from Int'l Films ADJ 08 13,660
Sold to MAF ADJ 09 (13,660)
Int'l Films on amts owed ADJ 10 (884)
Assets from Int'l Films ADJ 12 884

New balance 0

RWL Cinema Trust II
Payment from Int'l Films ADJ 08 43,101
Sold to MAF ADJ 09 (43,101)
Int'l Films on amts owed ADJ 12 (2,789)
Assets from Int'l Films ADJ 10 2,789

New balance 0

HGA Cinema Trust
Payment from Int'l Films ADJ 08 84,942
Sold to MAF ADJ 09 (84,942)
Int'l Films on amts owed ADJ 12 (5,497)
Assets from Int'l Films ADJ 10 5,497

New balance 0

Elk Investment
Payment from Int'l Films ADJ 08 48,604
Sold to MAF ADJ 09 (48,604)
Int'l Films on amts owed ADJ 10 (3,145)
Assets from Int'l Films ADJ 12 3,145

New balance 0

Inter Alia
Payment from Int'l Films ADJ 08 79,418
Sold to MAF ADJ 09 (79,418)
Int'l Films on amts owed ADJ 10 (5,139)
Assets from Int'l Films ADJ 12 5,139

New balance 0

Steve Hargen
Payment from Int'l Films ADJ 08 5,083
Sold to MAF ADJ 09 (5,083)
Int'l Films on amts owed ADJ 10 (329)
Assets from Int'l Films ADJ 12 329

New balance 0

Claude Ballard
Assets from Int'l Films ADJ 12 84,889
W/O worthless notes ADJ 28 (84,889)

New balance 0

Robert Lisle
Assets from Int'l Films ADJ 12 12,185
W/O worthless notes ADJ 28 (12,185)

New balance 0

Harold Abernathy
Assets from Int'l Films ADJ 12 28,939
W/O worthless notes ADJ 28 (28,939)

New balance 0

CMB Cinema Venture
Assets from Int'l Films ADJ 12 102

New balance 102

Invest in 1984 Development partnership
Int'l on amounts owed ADJ 10 32,854
Sold to MAF ADJ 11 (32,854)

New balance 0

Invest in Int'l Films
Unavailable history 65,000
Int'l Films stock worthless ADJ 34 (65,000)

New balance 0

Loss on sale of note receivable
Sold to MAF ADJ 09 507,608
Assets from Int'l Films ADJ 12 (162,721)
Sell N/R $1 not $10 ADJ 23 90
Sell N/R to MAF ADJ 32 831,692

New balance 1,176,670

Loss on worthless securities
Int'l Films stock worthless AJE 34 65,000

New balance 65,000

Loss on sale of 1984 Development Partnership
Sold to MAF ADJ 11 31,854
Assets from Int'l Films ADJ 12 (8,992)

New balance 22,862

Bad Debts
W/O worthless notes AJE 28 126,012
N/R-Forest worthless AJE 33 6,000

New balance 132,013

The following journal entries demonstrate the convoluted accounting Kanter engaged in to record the transactions on its books:
AJE 08: To record payment of Int'l Films $507,708 receivable by receipt of 10 receivables from Int'l Films:

Debit Credit
------- -------

N/R Safari Trust $62,550
N/R CMB Cinema Trust 44,887

N/R CMB Cinema Trust II 10,594
N/R RWL Cinema Trust 13,660
N/R RWL Cinema Trust II 43,101
N/R HGA Cinema Trust 84,942
N/R Elk Inv. 48,604
N/R Inter Alia 79,418
N/R Hargen, Karen & Steve 5,083
N/R HELO 114,870
N/R Int'l Films $507,708

AJE 09: To record the sale of the 10 receivables to MAF for $10 each:

Debit Credit
------- -------

Due from MAF $100
Loss on sale of notes rec. 507,608
N/R Safari Trust $62,550
N/R CMB Cinema Trust 44,887
N/R CMB Cinema Trust II 10,594
N/R RWL Cinema Trust 13,660
N/R RWL Cinema Trust II 43,101
N/R HGA Cinema Trust 84,942
N/R Elk Inv. 48,604
N/R Inter Alia 79,418
N/R Hargen, Karen & Steve 5,083
N/R HELO 114,870

AJE 23: To reduce the sale price of the receivables from $10 each to $1 each:

Debit Credit
------ -------

Loss on sale of N/R $90
Due from MAF $90

AJE 10: To record the receipt of Int'l Films' 1984 Development partnership interest by adjusting the 10 receivables transferred from Int'l Films and sold to MAF creating "negative" receivables:

Debit Credit
------- -------

Investment in 1984 Dev. Pship $32,854
N/R Safari $4,048
N/R CMB Cinema Trust 2,905
N/R CMB Cinema Trust II 686
N/R RWL Cinema Trust 884
N/R RWL Cinema Trust II 2,789
N/R HGA Cinema Trust 5,497
N/R Elk Inv. 3,145
N/R Inter Alia 5,139
N/R Hargen 329
N/R HELO 7,433

AJE 11: To record the sale of the 1984 Development partnership interest to MAF for $1,000:

Debit Credit
------ -------

Due from MAF $1,000
Invest. in 1984 Dev. pship $32,854
Loss on sale 1984 Dev. Ltd. 31,854

AJE 12: To again adjust assets from Int'l Films (1) to record receivables from Ballard, Lisle, Abernathy, CMB Cinema Venture, and Holding Co. and (2) to eliminate the 10 "negative" receivables, by reducing the amount of the loss on the sale of the 10 receivables to MAF by $162,721 and reducing the amount of the loss on the sale of the 1984

Development partnership interest by $8,992:

Debit Credit
------- --------

Loss on sale of N/R $162,721
Loss on sale of Pship 1984 Dev. 8,992
N/R Claude Ballard $84,889
N/R Robert Lisle 12,185
N/R Harold Abernathy (HGA) 28,939
N/R CMB Cinema Venture 102
N/R Holding Co. 12,743
N/R Safari 4,048
N/R CMB Cinema Trust 2,905
N/R CMB Cinema Trust II 686
N/R RWL Cinema Trust 884
N/R RWL Cinema Trust II 2,789
N/R HGA Cinema Trust 5,497
N/R Elk Inv. 3,145
N/R Inter Alia 5,139
N/R Hargen 329
N/R HELO 7,433

AJE 28: To write off Ballard, Lisle, and Abernathy receivables as bad debts:

Debit Credit
-------- -------

Bad debts $126,012
N/R Claude Ballard $84,889
N/R R. Lisle 12,185
N/R H. Abernathy 28,939

IRA computed the loss on sale of notes receivable from Int'l Films sold to MAF:

Sold to MAF ADJ 09 $507,608
Assets from Int'l Films ADJ 12 (162,721)
SL N/R $1 not $10 AJE 23 90

Loss on return 344,887

IRA computed the money loss on sale of 1984 Development as follows:

Sold to MAF ADJ 11 $31,854
Assets form Int'l Films ADJ 12 (8,992)

Loss on return 22,862

The adjusting journal entries and losses reported on IRA's return are summarized in the following chart:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
****
****
******** This is piece 1. -- It begins at character 1 of table line 1. ********

****
****
RECEIVABLES OWED TO
INT'L FILMS

AJE 8 AJE 9 AJE 23 AJE 10
--- --- --- ---
SAFARI $98,450 ($62,550) $62,550 $4,048
CMB CIN 70,650 (44,877) 44,877 2,905
CMB CIN II 16,675 (10,594) 10,594 686
RWL CIN 21,500 (13,660) 13,660 884
RWL CIN II 67,839 (43,101) 43,101 2,789
HGA CIN 133,695 (84,942) 84,942 5,497
ELK INV 76,500 (48,604) 48,604 3,145
INTER ALIA 125,000 (79,418) 79,418 5,139
HARGEN 8,000 (5,083) 4,083 329
HELO 180,800 (114,870) 114,870 7,433
--- --- ---
799,109 (507,708) 507,870

BALLARD 196,684
LISLE 28,284
ABERNATHY 67,098
CMB CIN VEN 250
HOLDING CO. 29,500

321,816

Total 1,120,925

1984 Devl 55,288 (32,855)

Total 1,176,213

Int'l Films receivable $507,708

Due from MAF ($100) $90
Loss on sale receiv (507,608) (90)
Loss on sale pship

Bad debts
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70...
****
****
******* This is piece 2. -- It begins at character 74 of table line 1. *********
****
****

AJE 11 AJE 12 AJE 28
--------- --------- ---------
($4,048)
(2,905)
(686)
(884)
(2,789)
(5,497)
(3,145)
(5,139)
(329)
(7,433)

(84,889) $84,889
(12,185) 12,185
(28,939) 28,939
(102)

(12,743)

$32,854

(1,000)
162,720
(31,854) 8,992

(126,013)
74...80....+...90....+....0....

In addition to the HELO note acquired from Int'l Films, IRA had another $485,825 receivable owed by HELO. [FN41] This second note was also sold to MAF along with a $345,869 note receivable from Cedilla Investment Co., one of IRA's subsidiaries, for $1 each, resulting in an additional $831,692 loss. As of August 31, 1987, Holding Co. had total assets of $11,552,887. Holding Co. had the resources to pay either IRA or Int'l Films when the receivable was written off.
In addition to the receivables MAF purchased from IRA, MAF purchased from Kanter for $27,949, a $311,878 promissory note owing by Victorian Village and a $23,356 promissory note from S. Block for $1. Kanter sold these promissory notes to MAF to create a $307,284 loss for tax purposes. By selling the notes, Kanter claimed the loss as having been realized by way of a sale or exchange rather than as bad debt losses.
MAF neither inquired into nor independently ascertained the value of the purchased promissory notes. MAF did not

examine and consider a particular note's collectibility or the creditworthiness of its maker or obligors. MAF later wrote off the notes as uncollectible.

By the end of 1987, neither Ballard nor Lisle owed any portion of their original "loans" totaling $196,648 and $28,284, respectively, to either IRA or Int'l Films. CMB Cinema Ventures no longer owed $250 to either IRA or Int'l Films. Likewise, Ballard's and Lisle's grantor trusts' original "loans" totaling $357,464 were no longer owed to IRA or Int'l Films.

In 1987, Ballard reported $2,400,252 total income on his Federal income tax return. Included in the $2,400,252 was $212,309 interest and dividend income and $1,018,367 capital gain income. In 1987, Ballard had the resources to pay either IRA or Int'l Films the "loans" owing by him and his grantor trusts. In 1987, when IRA wrote off Ballard's "receivable" as worthless, Ballard did not report the discharge of this indebtedness as income on his 1987 return or on subsequent returns.

In 1987, Lisle reported $746,923 total income on his Federal income tax return. Included in the $746,923 was $255,707 interest and dividend income. In 1987, Lisle had the resources to pay either IRA or Int'l Films the "loans" that he had received individually and through his trusts. In 1987, when IRA wrote off Lisle's "receivable" as worthless, Lisle did not report the discharge of this indebtedness as income on his 1987 return or subsequent returns. In 1988, the year after IRA wrote off loans owing by Lisle and his trusts (RWL Cinema, RWL Cinema II, and Basking Ridge), IRA made another "loan" to the RWL Cinema Trust in the amount of $6,000. In addition, KWJ, Inc., or Kanter continued to "lend" money in 1989 and again in 1990 to Lisle's RWL Cinema Trust.

Neither Ballard, Lisle nor their trusts paid any interest to Int'l Films on the "loans" to them which were subsequently written off as worthless or sold for $1 by IRA. There were no notes or any other loan documentation evidencing the

purported loans to Ballard, Lisle, and their trusts.

On March 8, 1989, approximately 2 years after Int'l Films transferred $1,120,889 of "receivables" to IRA, Int'l Films filed for bankruptcy. At the time of the bankruptcy filing, Gallenberger was the vice president of Int'l Films and owned 100 percent of its stock. At the time of Int'l Films' bankruptcy, Int'l Films owed debts to the following creditors:

Creditors	Reason	Amount
IRS	1984 taxes	$5,500
Kanter	Legal services	750
Neal Gerber & Eisenberg	Legal services	550
Personal Service Corp.	Services	700
I & F Corp.	Services	775
Total		$8,275

Question 15 of the Statement of Financial Affairs for Debtor Engaged in Business attached to Int'l Films' Voluntary Petition for Bankruptcy asked:

Accounts and other receivables:

Have you assigned, either absolutely or as security, any of your accounts of other receivables during the year immediately preceding the filing of the original petition herein? (If so, give names and addresses of assignees)?

In response to this question, Gallenberger answered "No."

The transfer and write-off of the receivables shown in the following series of diagrams:

1983 Step 1:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

1983 Step 2:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

1987 Step 1:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

1987 Step 2:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

C. Payments to Holding Co. and Its Subsidiaries

After Ballard and Lisle left Prudential, Lisle began working for Travelers. Schaffel paid IRA $213,750, 50 percent of the fees he earned from the first Travelers' financing approved by Lisle. After the first payment, Schaffel failed to pay Kanter on succeeding projects financed by Travelers. After discussions with Lisle, Schaffel agreed to make payments to Kanter, but under a different arrangement. Kanter directed Schaffel to make the payments to Holding Co. Schaffel paid Holding Co. $600,000 in 1984, $1,160,000 in 1985, and $1,003,500 in 1986 for transactions with Travelers.

Frey and Essex made the following payments to Holding Co., during the years 1981 through 1989:

Year	Frey	Essex	Total
1981	$80,616	--	$80,616
1982	--	$70,538	70,538
1983	16,200	64,125	80,325
1984	113,827	109,013	222,840
1985	256,557	98,325	354,882
1986	--	65,835	65,835
1987	33,570	98,753	132,323
1988	--	96,188	96,188
1989	--	42,332	42,332
Total	500,770	645,099	1,145,879

The following diagram shows the money paid to IRA and Holding Co. by Schaffel for the Travelers financing transactions, and by Essex and Frey to Holding Co. and Zion:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

D. Distributions to Kanter

Kanter had funds in both the Administration Co. Special E Account and the Special Account. Administration Co. paid some of Kanter's business and personal expenses out of Kanter's funds in these accounts. During 1982 Kanter received the following amounts from the payers or sources indicated:

Payer/Source	Funds Received
Holding Co.	$787,129
Computer Placement Service	40,000
Special E Account	190,078
Special Account	286,000
Total	$1,303,207

In 1983, Administration Co. paid $143,489 in employee compensation and distributed over $500,000 as nonemployee compensation, including $400,000 to the Rainbow Trusts (Rainbow Trust Nos. 1-25). Prior to 1987, Administration Co.'s assets consisted primarily of cash and receivables. For example, for the years 1983, 1984, and 1986, Administration Co. listed the following assets on its tax returns:

Fiscal Year	Cash on Hand	Current (Notes Receivable)	Assets	Total Assets
6-30-83	$77,735	$ 998,118		$1,117,457
6-30-84	23,941	4,501,125		4,577,701
6-30-86	55,821	4,365,144		4,512,704

Some of Administration Co.'s receivables represented money distributed to Kanter or trusts for the benefit of his family. For example, in 1984, Administration Co. distributed

$660,000 to Kanter that was recorded as a receivable. Administration Co.'s trial balance for the twelve months ended 6/30/84 reflects the following notes receivable from Kanter and his grantor trusts:

Entity	Amount
Everglades Trust 1-5	$23,595
Everglades Trust 2	1,000
Everglades Trust 3	1,000
Everglades Trust 4	1,000
Kanter, Burton W.	660,845
Total	$687,440

As of January 1, 1987, Kanter's general ledger indicated that Administration Co. had distributed a total of $1,056,751 to him. By the end of Administration Co.'s fiscal year ended June 30, 1987, its total assets were as follows:

Fiscal Year	Cash on hand	Current Assets (Notes Receivable)	Total Assets
6-30-87	$ 100	$6,929	$63,880

Administration Co.'s return for the year ended June 30, 1987, was the last return filed for Administration Co. Although the receivables on Administration Co.'s books decreased, as of October 31, 1987, Kanter still had an outstanding loan from Administration Co. in the amount of $1,346,641.
Administration Co. filed for bankruptcy. Sometime in either 1987 or 1988, during the bankruptcy proceedings, Gallenberger gave to Kanter Administration Co.'s records, including Administration Co.'s bank statements and canceled checks and the records related to Kanter, IRA, and Holding Co. The documents were never returned by Kanter to Gallenberger. The records would show the amount of

moneys in Administration Co.'s accounts held for Kanter and the related Kanter entities. Administration Co.'s bankruptcy was terminated on April 19, 1988.
During Administration Co.'s bankruptcy, a new company called Administrative Enterprises began its operations. By the end of the year December 31, 1987, Administrative Enterprises filed its initial return, which reported cash on hand of $11,548 and current assets (receivables) of $100.
For each of the years 1979 through 1989, Kanter filed his individual Federal income tax returns which reported adjusted gross income and income taxes paid as follows:

Year	Adjusted Gross Income (Loss)	Tax Paid
1978	($44,386)	$ 1,671
1979	(105,084)	--
1980	(155,026)	--
1981	(53,614)	--
1982	(287,536)	--
1983	(819,449)	--
1984	(804,482)	--
1985	(954,695)	--
1986	(1,529,213)	--
1987	(2,004,257)	--
1988	(1,340,459)	--
1989	(1,331,576)	--

Kanter paid no Federal income taxes for an 11-year period, and only minimum tax in 1978 of $1,671. However, he did pay self-employment tax for the years 1978 ($1,434), 1979 ($1,855), 1980 ($2,098) and 1983 ($3,338).
E. Examination of Petitioners' Returns
In November 1989, the Internal Revenue Service began an examination of Kanter's income tax returns. Several years were under examination.
In connection with the investigation of IRA for 1987, an IRS

agent received documents from Gallenberger and Kanter. The types of documents which the agent received included financial records, billings, invoices, expense items and various accounting records and corporate records. The agent reviewed the records to determine who the shareholders of IRA were in 1983. The records indicated that the shareholders of IRA for the year 1983 were: The Ballard Family Trust; The Lisle Family Trust; Weisgal as trustee of the Bea Ritch Trust; and Schott. IRA's minute books reflected that, as of 1984, the only shareholder of IRA was the Bea Ritch Trusts.

Pursuant to a summons to testify, Ballard was interviewed by IRS agents in February of 1990 at his residence in Florida. At the time of the interview, Ballard was not under audit. Ballard understood that he was not under audit and testified under oath. The purpose for the interview was to ask Ballard questions about Kanter's transactions involving Ballard. Sometime after the interview, Ballard's and Lisle's returns also were audited. The group of examining agents auditing the returns of Kanter, Ballard, and Lisle encountered difficulties because of the numerous entities related to Kanter involving transactions with him.

The investigation expanded. The IRS began interviewing more and more witnesses. By November of 1989, the Criminal Investigation Division (CID) was conducting an investigation.

In February 1990, Kanter sent letters to Ballard's and Lisle's children terminating the payments they had been receiving. In Kanter's letter, he stated that the Ballard and the Lisle children had not done anything for a number of years and blamed Freeman for continuing to have paid them. On November 20, 1990, Lisle wrote a letter to Kanter explaining to Kanter the reasons why he managed Carlco for no compensation. Lisle stated that there could have been a conflict of interest with Travelers, and it was "a learning experience managing a municipal bond fund." He told Kanter that he was going to begin charging a fee because

what he was doing took more of his time. Likewise, after Ballard was interviewed by the IRS in 1990, Ballard began taking a salary from TMT.

By letter dated December 17, 1992, Kanter wrote Ballard regarding an obligation purportedly due by Ballard to Int'l Films in the amount of $196,684. In the letter, Kanter requested that Ballard pay $120,000 in satisfaction of this prior obligation, to "simply avoid any controversy with me or anyone else." The $196,684 was the amount that had been written off by IRA as a bad debt in 1987.

During the audit of Kanter's 1987 and 1988 returns, the IRS requested information including data pertaining to transactions with the Five. The documents produced by Kanter during the audit were in many instances incomplete with many missing pages. Moreover, no documents pertaining to the $1,345,641 that Kanter received as a loan from Administration Co. were provided. Kanter, Ballard, and Lisle did not produce the records sought by the IRS in connection with the business entities relating to them. Nor did the IRS receive records voluntarily from any of the entities that had transactions with them. The records that were produced generally were relevant only to Schedule A substantiation items, such as records related to charitable contributions.

As a result of petitioners' failure to produce documents voluntarily, the complexity of the transactions involved, and the number of entities involved, the IRS issued summonses in order to obtain the necessary documents and information to conduct the examination. Numerous summonses were issued to Kanter, Ballard, and Lisle, as well as to many of the entities involved.

The IRS issued the following summonses to the following on the dates indicated:

Summons issued to	Tax Year	Date of Summons
Claude Ballard	1984	July 25, 1991

Linda Gallenberger 1984 January 10, 1991
In the matter of Claude & Mary Ballard
Linda Gallenberger 1984 January 10, 1991
In the matter of Robert Lisle & Donna Lisle
Linda Gallenberger 1984 January 10, 1991
In the matter of Claude & Mary Ballard
Donna Lisle 1984 July 30, 1991
Linda Gallenberger 1984 January 10, 1991
Robert Lisle 1988 July 30, 1991
Linda Gallenberger, Officer 1984 January 10, 1991
Principal Service Corp.
In the matter of Robert Lisle & Donna Lisle
Principal Service Corp. 1983, October 1, 1990
1985-1988
In the matter of Burton & Naomi Kanter
Mildred Schott 1983, April 30, 1990
1985-1988
In the matter of Burton & Naomi Kanter

Summonses were also served on Administrative Enterprises, Principal Services, Zion, and BK Childrens Trust.
The summons to Ballard dated July 25, 1991, requested, in part, documents in his possession pertaining to TMT, IRA, and the Orient Trust.
One of the summonses to Gallenberger dated January 10, 1991, in the matter of Ballard, requested, in part, documents in her possession pertaining to TMT, KWJ Co., Sherwood Associates, Orient Trust, Essex Hotel Management, and all documents evidencing loans to and from the Ballards with TMT. The other summons to Gallenberger dated January 10, 1991, in the matter of Ballard, requested, in part, documents in her possession pertaining to IRA, KWJ Co., Sherwood Associates, Essex Hotel Management, Int'l Films, and all documents evidencing loans to and from the Ballards with IRA.
The summons to Gallenberger dated January 10, 1991, in the matter of Lisle, requested, in part, documents in her

possession pertaining to IRA, Int'l Films, KWJ Co., Sherwood Associates, Essex Hotel Management, and all documents evidencing loans to and from the Lisles with IRA.
The other summons to Gallenberger dated January 10, 1991, in the matter of Lisle, requested, in part, documents in her possession pertaining to Carlco, Christie Trust, KWJ Co., Sherwood Associates, and Essex Hotel Management and loans between Carlco and the Lisles.
The summons to Donna Lisle dated July 30, 1991, requested, in part, documents in her possession as officer of Carlco pertaining to Carlco, IRA, and the Christie Trust.
The summons to Lisle dated July 30, 1991, requested, in part, documents in his possession pertaining to Carlco, IRA, Christie Trust, and loans between Lisle and IRA, Carlco, and Christie Trust.
The summons to Gallenberger as an officer of Principal Services dated January 10, 1991, requested, in part, documents in Principal Services's possession pertaining to Carlco, Christie Trust, and loans related to Lisle.
The summons to Principal Services dated October 1, 1990, requested, in part, documents pertaining to Principal Service Corporation, IRA and its subsidiaries, Holding Co. and its subsidiaries, BWK, Inc., and the Bea Ritch Trusts. The summons requested production of the cash receipts, cash disbursement journals, general ledgers and ledgers for all bank accounts including the Special E account. The summons also requested production of documents pertaining to any corporation or partnerships in which Kanter, his family or family trusts were shareholders.
The summons to Schott dated April 30, 1990, requested, in part, documents pertaining to Cedilla Company, IRA and its subsidiaries, Kanter, Ballard, Lisle, Schaffel, Frey, Weaver, KWJ Corp., Motor Hotel Management Inc., Essex Hotel Management Co., and Schnitzer-PMS.
The documentation sought in the summonses served on petitioners, Principal Services, Linda Gallenberger on behalf of Principal Services, and Mildred Schott was relevant to the

issues in these cases. Petitioners, Gallenberger, Principal Services, and Schott did not voluntarily turn over documents and information listed on the summonses to the agents during the audit.

None of the above information requested was produced pursuant to the summonses. In fact, petitioners did not produce anything in response to the summonses, including documents evidencing loans between themselves and the various entities.

Principal Services maintained Kanter's personal records, the records of his family entities and trusts, the records of IRA and Holding Co. Kanter controlled Principal Services and Gallenberger. During discovery in these cases, respondent requested receipts and disbursement journals for Holding Co. for all of the years at issue. Kanter first promised to produce Holding Co.'s books and records in the possession of Principal Services and then, in early February 1994, notified respondent that the Holding Co. was a third-party over which he had no control. Initially, Gallenberger had in her possession the records of Holding Co. for the years 1986, 1987, and 1988. After respondent requested production of the Holding Co. records, Kanter never asked Gallenberger for them. At some point, however, she turned those records over to Kanter.

On April 1, 1994, the Government sought enforcement of four summonses that had been served in 1990 and 1991 on Administrative Enterprises, Principal Services, Zion, and BK Childrens Trust (which is one of the twenty-five trusts which comprise the Bea Ritch Trust group). See United States v. Administration Co., 74 AFTR 2d 94-5252, 94-2 USTC par.50,479 (N.D.Ill.1994). On April 4, 1994, the District Court issued an order to show cause why the Kanter-related entities should not be compelled to obey the four summonses.

In connection with the instant cases, Gallenberger was served by respondent with a discovery subpoena to produce documents. On May 18, 1994, Gallenberger appeared at the

deposition without the requested documents. At the deposition, Gallenberger stated that she did not have the records because of a 3-year retention policy. Even under Gallenberger's alleged records retention policy, however, documents of an individual or entity under audit were not destroyed until the audit was completed.

On the following day, May 19, 1994, a hearing was held in the District Court on the Government's motion to enforce the administrative summonses. At the hearing, Weisgal, who was served as the named trustee of the BK Childrens Trust, admitted that, after he received the summons, some of the documents, including documents relating to the Kanters, had been turned over to Administration Co. and that some had been discarded as part of a 3-year record retention and discard policy.

Gallenberger, who had been served with summonses as president of Administration Co., Principal Services, and Administrative Enterprises, also admitted at the hearing that she disposed of some documents after she received the IRS summons and claimed that documents relating to Administration Co. were never returned to her from bankruptcy counsel. [FN42] On May 20, 1994, the District Court ordered the records sought by the summonses be produced to the IRS by May 24, 1994. United States v. Administration Co., 74 AFTR 2d 94- 5252, 94-2 USTC par. 50,480 (N.D.Ill.1994).

Although Gallenberger appeared, testified, and produced some documents on May 24, 1994, in accordance with the District Court's order, she did not search all of the approximately 52 filing cabinets of records in her possession, but instead looked in every fifth or seventh file. The Government filed another motion on June 10, 1994, and, on June 22, 1994 a hearing was held. See United States v. Administration Co., 74 AFTR 2d 94-5256, 94-2 USTC par. 50,480 (N.D.Ill.1994). At this second hearing, Gallenberger admitted that Principal Services operated much like a registered agent and a document repository, but existing

primarily for the Kanters' benefit. Gallenberger knew that most of the documents held by Principal Services were related to Kanter entities. The District Court concluded that Gallenberger's sampling of documents did not discharge her duty to make all reasonable efforts to comply with the court's order. Finding a "glaring deficiency in her compliance," the District Court held Gallenberger in contempt of court and granted her until July 1, 1994 to comply fully with the court's order. Id. at 5258, 94-2 USTC ¶ 50,480 at 85,770. Gallenberger complied with the District Court's order of June 22, 1994, but appealed the order to the Court of Appeals for the Seventh Circuit. The Court of Appeals affirmed the District Court's order in United States v. Administrative Enters., Inc., 46 F.3d 670 (7th Cir.1995). [FN43]

The trial of these cases commenced on June 13, 1994. At the start of the trial, respondent's counsel indicated that subpoenas duces tecum had been served on various entities for documents that were to be produced at that time. Counsel for IRA and Kanter informed the Court that the subpoenas requesting documents from IRA, BWK, Inc., Carlco, and TMT had been served on Gallenberger, but that Gallenberger was not the custodian of the records. Rather, Kanter was the custodian of the records. Respondent immediately served Kanter with a subpoena requesting records relating to Holding Co. and its subsidiaries, IRA and its subsidiaries, Carlco, TMT, and BWK, Inc. The subpoena requested corporate minute books, corporate minutes, articles of incorporation and all amendments thereto, stock registers, stock certificates, certificates of authority, bylaws and all amendments thereto, and all subscription agreements and agreements thereto. In addition to the books and records, respondent also requested production of documents reflecting the ownership of IRA, Holding Co., Carlco, TMT, and BWK. Specifically, respondent requested production of the following original documents:

All books, records or other documents evidencing the ownership of the following entities: IRA, Holding Co.,

Carlco, TMT, BWK, ... including but not limited to stock ledgers and records of stockholders.

Although Kanter produced some documents, many records were not produced. Absent from the record are resolutions by the board of directors of Carlco and TMT setting forth the preferences of the preferred stock.

With respect to Holding Co., Kanter produced Holding Co. trial balances only for the years 1980 and 1981. Respondent had from prior audits partial general ledgers of Holding Co. for 1983, 1984, and 1985, and partial trial balances of Holding Co. for 1983, and 1984. There are no receipts and disbursement journals, general ledgers, or trial balances for Holding Co. for the years 1980, 1981, 1982, 1985 (partial), 1986, 1987, 1988, and 1989. Respondent sought the records because the Five made payments to Holding Co. during those years.

When the trustees of Kanter's family trusts, Baskes and Weisgal, were asked to produce documents, they, likewise, failed to do so on the ground that they did not have the requested information in their possession.

Gallenberger took the position that a request for documents in the possession of Principal Services was a request for the documents of Principal Services, and not the records maintained by Principal Services for Kanter or Kanter-related entities. She claimed that Principal Services had a policy of refusing to turn documents over to anyone other than the owner.

OPINION

By this point, the complexity of these cases is apparent. That complexity is reflected in the sheer magnitude of the record and is exacerbated by the contentiousness of the parties. The trial in these consolidated cases lasted almost 5 weeks, and produced a transcript of 5,411 pages. The parties' combined briefs contain 4,668 pages and address over 40 issues. We have plodded through thousands of exhibits containing hundreds of thousands of pages. Not surprisingly, our task of finding the facts has been laborious and frequently

frustrating.

Unless otherwise indicated, references hereinafter to petitioners are to Ballard, Lisle, and Kanter, collectively.

I. Position of the Parties

Respondent contends that the payments made by the Five to the various Kanter entities were kickbacks paid to petitioners for their influence and assistance in acquiring business with Prudential, Travelers, and others. Specifically, respondent alleges that (1) when Ballard and Lisle were employed by Prudential, petitioners received kickbacks from the Five that petitioners agreed to split 45 percent each to Ballard and Lisle and 10 percent to Kanter (the Prudential transactions), (2) when Lisle worked for Travelers, Lisle and Kanter received kickbacks that were split 90 percent to Lisle and 10 percent to Kanter (the Travelers transactions), and (3) Kanter alone received kickbacks for transactions that were not necessarily related to Prudential and Travelers (the Kanter transactions).

Respondent contends that the payments constituted income to petitioners that they failed to report on their Federal income tax returns. It is asserted that the payments related to the Prudential transactions are taxable 45 percent each to Ballard and Lisle and 10 percent to Kanter, the payments related to the Travelers transactions are taxable 90 percent to Lisle and 10 percent to Kanter, and the payments related to the Kanter transactions are taxable 100 percent to Kanter. In the alternative, respondent asserts that, if any of the payments related to the Prudential and Travelers transactions are not taxable to Ballard and Lisle, the payments are taxable 100 percent to Kanter.

Respondent maintains that Kanter, in carrying out the Prudential and Travelers schemes, routed the kickback payments through IRA and Holding Co., two entities that he controlled, to conceal from Prudential and Travelers (Ballard's and Lisle's employers) the fact that Ballard and Lisle were receiving kickbacks. As a further part of the Prudential kickback scheme, respondent argues, Kanter later

directed and allocated much of the kickbacks IRA received from the Five to IRA's subsidiaries, Carlco, TMT, and BWK, Inc., roughly in accordance with the respective 45-45-10-percent split agreed to by Ballard, Lisle, and Kanter. In doing this, respondent claims that Ballard, Lisle, and Kanter each then controlled and managed his respective share of the kickbacks from the Prudential scheme. Although Ballard's and Lisle's purported shares of the kickbacks were not immediately paid to them, respondent asserts that substantial funds eventually were either paid out or provided to them and their families through "loans" and "consulting payments" to their children.

Respondent argues that IRA, its subsidiaries Carlco, TMT, and BWK, Inc., and Holding Co. were sham or dummy corporations that should not be recognized as separate taxable entities. In the event the Court decides that the corporations were not sham or dummy corporations, respondent argues in the alternative that petitioners are taxable on the income under the assignment of income doctrine or pursuant to section 482.

Petitioners, on the other hand, dispute respondent's characterization of such payments as kickbacks and their attribution to Kanter, Ballard, and Lisle. Petitioners deny that any kickback schemes existed and contend that the payments from the Five were properly taxable to IRA, Holding Co., or one of their subsidiaries. Petitioners contend that all of the payments were reported on the respective tax returns of IRA and Holding Co. during the years at issue and that such income was properly taxable to IRA, Holding Co., and/or their subsidiaries, and not to Ballard, Lisle, and/or Kanter, as respondent asserts.

Petitioners contend that the corporations were not shams and that the assignment of income doctrine and section 482 are inapplicable.

II. Omitted Income

Since all of the payments by the Five were made to entities associated with and controlled by Kanter, and, from there,

the payments flowed through to Kanter, Ballard, and Lisle, it is appropriate to consider first whether the payments made to Kanter's entities are attributable to petitioners, because if we conclude that such payments were not attributable to them, it follows that such payments or portions thereof are attributable to the entities that received the payments.

A. The Transactions

We begin by examining the transactions at issue.

1. The Hyatt Payments

In a joint venture with others, Prudential built the Embarcadero Hotel and sought a management company to operate it. Originally, only Webb and Intercontinental were considered for the management contract on the hotel. Although Hyatt had successfully negotiated the management contract for the Houston Hyatt Hotel, in which Prudential was involved, Lisle was not interested in having Hyatt bid on the management contract for the Embarcadero Hotel. Pritzker offered to pay 10 percent of the management fees to Weaver if he could get Prudential to award the contract to Hyatt. Weaver then convinced Lisle to allow Hyatt to bid on the contract.

Representatives of the hotel's owners, including Lisle and Ballard representing Prudential, then met with Webb and Pritzker to obtain bids on the management contract. Apparently, since Intercontinental was not represented at the meeting, Intercontinental either withdrew or was eliminated from consideration prior to the meeting. Webb refused to submit a bid at the meeting because he thought he had previously been promised the contract. Hyatt submitted the only bid and was subsequently awarded the contract.

Hyatt then executed a written agreement with Weaver's KWJ Corp. dated February 25, 1971, pursuant to which Hyatt agreed to pay KWJ Corp. 10 percent of the management fees Hyatt earned from management of the hotel. The agreement acknowledged that "KWJ" was the principal factor in bringing Hyatt Corp. and the owners of the Embarcadero Hotel together and aiding in the negotiations.

The hotel opened in May 1973. Apparently, Hyatt did not make a profit the first year, and no payments were made to KWJ Corp.

In 1975, a dispute arose between Weaver and Hyatt as to whether KWJ Corp. was entitled to management fees for 1974. The dispute was settled in November 1975.

Before the dispute was settled, Weaver and Kanter agreed that Weaver would sell all the stock of KWJ Corp. to IRA. They executed an agreement dated March 10, 1976, acknowledging the agreement. The agreement gave IRA the option to purchase the stock within 4 years for $150,000 plus an amount equal to 30 percent of all payments received by KWJ Corp. from Hyatt after the purchase. In September 1979, Kanter informed Weaver that he wanted to proceed with the purchase of the KWJ Corp. stock. The sale was made effective retroactively to November 1, 1978.

Petitioners would have us end our examination of the transaction at this point and hold that the sale was a valid arm's-length sale of the stock to IRA. The Court declines to do so because it would ignore the true substance of the transaction and give new meaning to the expression "blind justice". We think the true substance of the transaction is clearly disclosed when one follows the flow of the money.

The only activity conducted by KWJ Corp. and later the KWJ Co. partnership, was receiving the Hyatt payments. IRA was to pay $10,000 of the purchase price in November 1979 and the balance by August 1980. Hyatt paid over $170,000 to KWJ Corp. in 1979. Thus, IRA simply paid the purchase price from the Hyatt payments.

After paying 30 percent of each of the Hyatt payments to Weaver, the remaining funds were (1) distributed as "consulting fees" to Ballard's and Lisle's children, (2) filtered along with other payments from the Five through IRA, Int'l Films, and HELO as loans to Ballard, Lisle, and Kanter, and (3) distributed to Carlco, TMT, and BWK, Inc. Lisle's control over the Carlco assets, Ballard's control over the TMT assets, and Kanter's control over the BWK, Inc. assets went

unfettered. Petitioners had unrestricted power to use the funds for their personal benefit and in fact did so.

The record clearly and convincingly shows that Weaver agreed to split his Hyatt commissions with Ballard and Lisle in exchange for their influence in having the management contract awarded by Prudential and its co-owners to Hyatt. The record also shows by clear and convincing evidence that Lisle and Ballard agreed to pay Kanter 10 percent of their share of the payments in exchange for Kanter's facilitating the concealment and distribution of the funds. Additionally, the transfer of the stock to IRA allowed petitioners to offset the income from the Hyatt payments with tax-shelter losses claimed on IRA's consolidated returns. The entire arrangement was implemented in order to conceal Ballard's and Lisle's participation from Prudential and Kanter's participation from Hyatt and to avoid Federal taxes.

When Weaver sent to IRA the 1983 payment from Hyatt for the management fees earned in 1982, he wrote in the letter dated March 29, 1983: "Will you please deposit and issue appropriate checks to the participants." If there was no agreement to split the fees with petitioners, we think it more likely that Weaver would simply have directed IRA to remit to him his 30 percent. KWJ Corp. had not been liquidated; Carlco, TMT, and BWK were not "active" (no stock had been issued); and the KWJ Co. partnership had not yet been formed. We are convinced that the reference to the "participants" was to Ballard, Lisle, and Kanter, as well as Weaver.

Petitioners assert that Ballard and Lisle did not have the power to award the contract to Hyatt in part because their positions with Prudential did not give them such authority and in part because there were others besides Prudential participating in the project. Although Ballard and Lisle may not have been in a position to guarantee that the contract would be given to Hyatt, their opinions as Prudential executives would have influenced the other owners. Certainly a negative opinion with respect to a bidder would

have foreclosed the possibility of the bidder getting the contract. Strum, CEO of the Prudential Realty Group for Development and Retail Property Investments, testified that Ballard had the "hierarchy power" either to influence the selection of contractors or to prevent a project from going forward. Initially, Lisle used his "prevention power" to keep Hyatt even from being considered for the management contract. Ballard and Lisle may not have had the power to guarantee that Hyatt would get the contract, but they did have the power to guarantee that it would not get the contract.

Kanter claims that he did not know about Hyatt's arrangement with Weaver until Pritzker later asked him about some language in the agreement. The copies of the correspondence between Weaver and Hyatt concerning the dispute over the computation of the fees were copies that Kanter had in his records. He claimed that Pritzker gave him the copies in the course of Pritzker's consulting with him regarding the dispute with Weaver.

The letter acknowledging Weaver's prior understanding that he would sell all the stock in KWJ Corp. to Kanter's "client" (IRA) for $150,000 is dated March 10, 1976. Kanter admitted that he and Weaver had been discussing the sale for some time before March 10, 1976. At trial he testified that he did not know whether it was a few months before or a much longer period of time. Kanter testified that "J.D. [Weaver] needed money and was clearly unhappy with what might be the interpretation of the contract in light of his dispute with Abe [Pritzker], and it led to this letter."

We find Kanter's testimony to be implausible. We find it incredible that an attorney consulting with a very important client about a contract dispute would surreptitiously negotiate with the other party to the contract to purchase essentially the same contract that was the subject of the dispute and on which the attorney was giving advice.

We are not convinced that Kanter obtained the copies of Hyatt's correspondence with Weaver from Pritzker rather

than from Weaver. Kanter was not Hyatt's attorney. He represented the Pritzker family, but Hyatt had its own attorneys, including members of the Pritzker family who themselves were attorneys. Kanter testified that he had very limited involvement with respect to the Embarcadero Hotel project and that, although Hyatt Corp. had full-time tax counsel representing it, there were some isolated tax questions with which he was involved. He testified that, at that time, his office did not do anything but tax work and he had no involvement with any other part of the project or contract.

Kanter also claims that Weaver gave IRA 4 years to buy the stock for two reasons: First, because Weaver needed the money, and, second, because Hyatt was attempting to become privately owned and Hyatt would not want to disclose the agreement. Kanter claimed that the reason Hyatt would not want to disclose the agreement was because others might expect similar fee-splitting arrangements in negotiating for other projects.

Again, Kanter's explanation is implausible. If Weaver needed the money, we do not think he would agree to put the sale off for up to 4 years. Furthermore, Hyatt's contract with KWJ Corp. already existed. Hyatt either had to disclose its contract with KWJ Corp. in accordance with the securities laws or it did not. We fail to see how the sale of the stock to IRA would affect the disclosure requirement unless IRA was somehow considered an interested party or an insider with respect to Hyatt Corp. We think it more likely that Kanter did not want to disclose the purchase to Hyatt Corp. or the Pritzkers. In fact, Kanter did not disclose the purchase of the stock, the liquidation of KWJ Corp., or the assignment of the contract rights to the KWJ Co. partnership until sometime around 1992.

Furthermore, there was no reasonable explanation for Weaver's selling the stock in KWJ Corp. to IRA for $150,000 plus an amount equal to 30 percent of all payments received by KWJ Corp. from Hyatt. Weaver was experienced enough

to know that the contract was worth millions of dollars. By selling the stock, he effectively gave up 70 percent of the contract rights. It would have been less costly to hire another attorney to represent him in enforcing the agreement. Moreover, if Weaver had expected Hyatt to make the payments more readily because of Kanter's relationship to IRA and the Pritzkers, then Weaver would have notified Hyatt of the sale of the stock. That he did not do. Instead, he continued to receive the payments from Hyatt which he then forwarded to IRA. It is clear that Weaver and Kanter intentionally concealed the sale of the KWJ Corp. stock from Hyatt until Kanter's relationship with Weaver deteriorated around 1992.

Similarly, the Court also finds that the "consulting payments" Kanter arranged to have KWJ Corp., and later the KWJ Co. partnership, pay to Ballard's and Lisle's children from about 1983 through 1989 were part of the kickback scheme. Although referred to as "children", they were adults and were all engaged in other employment, and no services were performed or expected of them for these payments. We hold that the Hyatt payments, less Weaver's 30 percent, were attributable to services provided by Kanter, Ballard, and Lisle.

2. The Frey Arrangement

Frey was engaged in the business of converting apartment complexes into condominiums. Frey agreed to share fees with Kanter in any project for which Kanter provided investors.

Frey's agreement that he would share development and management fees with Kanter was formalized in two separate written agreements each dated October 12, 1981. One agreement was between Frey and IRA's subsidiary Zeus, and the other agreement was between Frey and Holding Co.

The written agreement with Zeus covered development fees and profits shares from all condominium conversions of property of or for Prudential, including all prior and future

conversions. The agreement did not provide for termination by either party and did not require Zeus to provide any funds or services.

All of Zeus' income was attributable to the payments from the Frey corporation, interest income, and income from partnerships. The commission payments from Frey were unrelated to Zeus' investment in the partnerships. Zeus did not provide any capital or services for the commission payments. Frey agreed to pay Zeus and made the payments because Kanter used his influence with Ballard and Lisle, who in turn used their positions of authority at Prudential to influence Prudential in using Frey as the developer in the conversion of Prudential properties into condominiums. The payments were accumulated in Zeus (or distributed as loans) until 1983. In 1983, Zeus distributed the funds to IRA. In 1984 IRA distributed the funds to Carlco, TMT, and BWK, Inc., effectively distributing the funds 45 percent each to Ballard and Lisle and 10 percent to Kanter. Frey paid Zeus $103,500 in 1984 and $128,763 in 1985 (totaling $232,263). Although the money was accumulated in Zeus until it purchased the preferred stock in Windy City in 1986, IRA distributed $249,870 to the KWJ Co. partnership as "loans" from 1984 to 1989.

It is clear that the payments made by Frey to Zeus were for services provided by Ballard, Lisle, and Kanter.

The second agreement (between Frey and Holding Co.) applied to "capital contribution, profits and losses and Developers' Fees" for all condominium conversions excluding the developers' fees from Prudential projects that were covered by the agreement with Zeus. The agreement could be terminated by either party with 45 days' prior notice with the termination effective only with respect to new condominium conversions. Although the second agreement required Holding Co. to make capital contributions with respect to Holding Co's. investment as a partner, it did not require Holding Co. to make any contributions or provide any services in exchange for its

share of the developer fees at issue in this case. Furthermore, Holding Co. did not pay for its partnership interest. Rather, Frey paid the capital contributions, and Holding Co.'s share of profits was reduced by a portion of the contributions as the profits were distributed.

Frey paid a portion of his development fees and profit interest to Holding Co. for Kanter's services of providing other investors in the projects. Holding Co. did not provide any services or capital with respect to those fees.

We hold that the payments from Frey to Zeus are attributable to services provided by Ballard, Lisle, and Kanter, and the payments to Holding Co. are attributable to services provided by Kanter.

3. The Schaffel Arrangement

The arrangement between Schaffel and Kanter originated at the dinner with Ballard and Lisle in New York. At the meeting, Kanter offered his and "his associates" ' help in obtaining deals from which Schaffel could earn fees as a broker, provided Schaffel would agree to pay Kanter half of any broker's fees Schaffel received from the deals. Schaffel agreed, and Kanter helped Schaffel negotiate agreements with Torcivia and Walters. Pursuant to those agreements, Torcivia and Walters agreed to pay Schaffel 1 percent of the gross amount of the contract price of any construction contract that Schaffel helped obtain for their companies. Schaffel then executed a letter agreement to pay 50 percent of the fees he received for construction jobs in which Kanter or his "associates" had been instrumental or helpful in obtaining for Torcivia or Walters. Although the letter agreement is addressed to IRA, it is clear that the agreement was with Kanter and the reference to associates was to Ballard and Lisle.

As a result of the introduction to Ballard and Lisle, Schaffel began doing millions of dollars of business with Prudential, including construction contracts and financing for Torcivia and Walters, as well as others. From 1979 to 1983, Schaffel paid IRA $1,184,876 from these Prudential transactions.

After Ballard and Lisle left Prudential, Schaffel stopped negotiating contracts with Prudential. Instead, he began negotiating contracts for Torcivia and Walters with Lisle at Travelers. Schaffel paid IRA $213,750 from the first Travelers transaction. After that payment, however, Schaffel stopped paying IRA a share of the fees he earned on Travelers transactions. When Kanter contacted Schaffel and inquired as to why Schaffel was not remitting half the fees from Travelers transactions to IRA, Schaffel claimed that the prior agreement related to Prudential transactions did not apply to Travelers transactions. In the August 28, 1984, letter to Schaffel, Kanter asserted that the arrangement should continue because, in his view, Travelers had replaced Prudential as the principal source of the transactions because of the "very personnel" to whom Schaffel had been introduced. It is clear that the reference to personnel was to Ballard and Lisle.

After discussing the situation with Lisle, Schaffel agreed to resume payments for fees earned on Travelers transactions. Instead of paying IRA, however, Kanter had Schaffel send the payments from Travelers transactions to Holding Co. Ballard and Lisle knew that Kanter had an arrangement with Schaffel to share in the fees Schaffel earned on certain business deals, because they were present at the dinner meeting when Kanter initially proposed and discussed the arrangement with Schaffel. When Kanter and Schaffel had their dispute over whether IRA was entitled to a share of Schaffel's fees on business deals with Travelers, Lisle was concerned that a lawsuit between the two might cause problems for Lisle with Travelers. Lisle was concerned because he was involved with the arrangement and benefited from it.

The payments from Schaffel for the Prudential transactions were accumulated in IRA until the formation of Carlco, TMT, and BWK, Inc. In 1984, IRA transferred funds to the three new corporations in a 45-45-10 ratio, effectively transferring 45 percent to Lisle, 45 percent to Ballard, and 10

percent to Kanter. It is clear that payments Schaffel made to IRA were in part for Kanter's service of introducing Schaffel to Ballard and Lisle, and that Kanter agreed to share the payments with Ballard and Lisle in a 45-45-10 split. Although it is also clear that the payments Schaffel made to Holding Co. were for Kanter's prior service in introducing Schaffel to Lisle, the record does not show that the funds flowed through from Holding Co. to Lisle. The payments at issue do not include the payments Schaffel made through FPC Subventure. Lisle included 90 percent of the FPC Subventure payments in the income reported on his returns. There is no evidence in the record that Kanter otherwise agreed to share or did share the fees from the Travelers transactions at issue here with Lisle. Thus, we find that none of the payments were paid to Lisle for his services.

4. The Schnitzer Arrangement

In 1974, Schnitzer's holding company, Century, purchased Schnitzer-PMS (Fletcher Emerson at the time) for $1.3 million. The purchase price was based roughly on five times Fletcher Emerson's pretax earnings of approximately $250,000. [FN44] At the time of the purchase, Schnitzer-PMS had been managing a relatively small number of Prudential's commercial properties. Schnitzer wanted to expand Schnitzer-PMS' business, including its business with Prudential. Schnitzer approached Ballard and offered to give Prudential a 50- percent interest in Schnitzer-PMS. Prudential declined the offer.

Although the record shows that Ballard introduced Schnitzer to Kanter sometime between 1971 and 1976, it is not clear whether the introduction was made before or after Schnitzer proposed to give Prudential 50 percent of the Schnitzer-PMS stock. After Prudential declined Schnitzer's offer and prior to September 1976, Schnitzer and Kanter began discussing Kanter's purchasing 50 percent of Schnitzer-PMS. Kanter indicated that he could obtain additional business for Schnitzer-PMS through his business contacts, including his contacts with the Pritzkers. Before agreeing to the sale of the

stock, Schnitzer confirmed with Ballard that Kanter could bring in business for Schnitzer-PMS.

Kanter and Schnitzer agreed that Schnitzer-PMS would be recapitalized to provide for preferred stock to be issued to Century. The preferred stock was entitled to a preferred dividend equal to the amount of Century's bank loan outstanding on its original purchase of Fletcher Emerson. Century would receive the preferred stock and 52.5 percent of the common stock, and Kanter's client (IRA) would purchase 47.5-percent (51.3 shares) of the common stock for $150,000. Although closing was originally set for October 1976, because of difficulties in finalizing the agreement, closing did not take place until January 1978. IRA paid $50,000 at closing and issued a promissory note for the $100,000 balance.

Schnitzer's primary objective in selling the 47.5-percent Schnitzer-PMS interest to IRA was to acquire business from the Pritzkers and/or Hyatt which he felt could be obtained through Kanter's influence. By early 1978, although Schnitzer-PMS' business, in particular its business with Prudential, had greatly increased, it had not received any business from Hyatt. When such business was not forthcoming, Schnitzer decided that IRA should sell back the Schnitzer-PMS stock. Kanter offered to either sell IRA's stock in Schnitzer-PMS to Century or purchase from Century Development Corp. its stock in Schnitzer- PMS for $3.1 million. In November 1979, Century repurchased the 47.5 percent owned by IRA in July 1979 for $3.1 million, payable over a 10-year period with interest. At the time of the repurchase, approximately $700,000 remained outstanding on the loan for the original purchase of Fletcher Emerson. The payments for the repurchase of the Schnitzer-PMS stock were accumulated in IRA until the formation of Carlco, TMT, and BWK, Inc. In 1984, IRA transferred the funds to the three new corporations in a 45-45-10 ratio, effectively transferring 45 percent to Lisle, 45 percent to Ballard, and 10 percent to Kanter. After 1984, IRA continued to distribute

the installment payments to Carlco, TMT, and BWK, Inc. in the 45-45-10 ratio.

Respondent asserts that Schnitzer used the sale and repurchase of the stock as a means of paying a kickback to Ballard and Lisle for their influence in obtaining business with Prudential. It is argued that the kickback is evidenced by a bargain sale price and an excessive repurchase price. Petitioners argue that the purchase price was not a bargain purchase because at the time of the purchase, Schnitzer-PMS had assets with net book value of approximately $200,000 and 47.5 percent of that amount would be $95,000.

We do not think, however, that net book value of the corporation's assets is an appropriate measure of the value of a service corporation. We note that when the stock was repurchased in 1979 for $3.1 million, the corporation had net assets of $255,581. Additionally, Schnitzer's purchase price of $1.3 million for the Fletcher Emerson stock was based on five times the pretax income of approximately $250,000. Schnitzer-PMS' 1977 pretax income was $451,347. Five times Schnitzer-PMS' 1977 pretax income of $451,347 is approximately $2.2 million. Allowing for the value of the preferred stock liquidation dividend preferences equal to the $1.1 million debt outstanding on Century's original purchase of Fletcher Emerson, the value of Schnitzer-PMS common stock at the time IRA acquired the stock was approximately $1.1 million. IRA acquired 47.5 percent of the common stock with a value of at least $522,500 for $150,000. [FN45] Furthermore, IRA paid $50,000 at closing and issued a promissory note for the $100,000 balance. IRA did not pay the $100,000 until after Schnitzer told Kanter that he wanted to repurchase IRA's Schnitzer-PMS stock. Clearly, IRA's purchase of the Schnitzer-PMS stock was a bargain. Schnitzer sold the stock to IRA at the bargain price in exchange for Kanter's promise to use his influence with his clients, particularly the Pritzkers, to direct business to Schnitzer-PMS. Schott's and Weisgal's relationships to IRA, as well as their contacts, were irrelevant. Schnitzer would

have sold the stock directly to Kanter or to any entity that Kanter wanted to use for the transaction. Moreover, Schnitzer testified that he would have sold the stock for less than $150,000.

With respect to the repurchase price, Schnitzer-PMS' 1978 pretax income was $832,000. When IRA sold the stock back to Schnitzer, approximately $700,000 remained outstanding on the loan for the original purchase of Fletcher Emerson. Based on five times earnings, at the time of repurchase the entire business was worth approximately $4.2 million ($832,000 x 5); allowing for the liquidation and dividend preferences of the preferred stocks the common stock had a value of roughly $3.5 million ($4.2 million--$700,000), and IRA's 51.3 shares of common stock had a value of roughly $1.6 million ($3.1 million x 47.5 percent). [FN46] The Court notes, however, that around the end of 1979 or early 1980, Schnitzer discussed the sale of Schnitzer-PMS to Minneapolis Honeywell for a price between $12 million and $13 million. [FN47] Although Honeywell decided not to purchase Schnitzer-PMS, we think that when Schnitzer agreed to repurchase the Schnitzer-PMS stock from IRA, he thought the stock was worth $3.1 million. Otherwise, he would have sold Century's stock to IRA.

Schnitzer's primary objective in selling the 47.5-percent Schnitzer-PMS interest to IRA was to acquire business from Hyatt which he felt could be obtained through Kanter's influence. Apparently, when Schnitzer negotiated the reacquisition of the stock, he was unaware of the assistance from Ballard or Lisle for additional property management business with Prudential. Thus, although we find that Schnitzer sold the stock to IRA at a bargain price for Kanter's influence, we cannot say that Schnitzer intended the payments to repurchase the stock as kickbacks to Ballard and Lisle.

The flow of the money, however, makes it clear that Kanter agreed to share the money received from the transaction with Ballard and Lisle in exchange for their assistance in

giving more Prudential business to Schnitzer-PMS. The increase in the Prudential business greatly increased the pretax income and, thus, the value of the Schnitzer-PMS stock. IRA, as with the other transactions involving the Five, held for the benefit of Ballard, Lisle, and Kanter the funds received from the repurchase of its stock in Schnittzer-PMS, and distributed the funds to the individuals through Carlco, TMT, and BWK, Inc.

5. The Eulich/Essex Arrangement

The final arrangement involved petitioners, Eulich, and Connolly. Eulich was a real estate developer and had known Ballard and Lisle since at least 1965. Eulich dealt with Ballard and Lisle in connection with Prudential's financing his development of real estate. Eulich and Kanter had also known each other since the late 1960's or early 1970's and had had many business dealings with each other. Eulich owned a hotel management company called Eulich-Management. Connolly was an employee of another management company that managed Prudential's Gateway Hotel. Connolly was employed as the in-house manager of Prudential's Gateway Hotel. In 1981, Connolly threatened to quit because he wanted an increase in his compensation. Prudential began discussing giving the management contract to Connolly.

Ballard introduced Connolly to Eulich. Kanter, Eulich, and Connolly then organized two corporations, a hotel management company called Gateway Corp. and Essex Corp. (incorporated in 1981). Eulich provided $10,000 for the initial capitalization of Gateway Corp. Connolly was issued all of the stock of Gateway Corp., but granted Essex Corp. a 10-year option to purchase 80 percent of the stock.

By February 1, 1982, Gateway Corp. entered into management contracts with Prudential to operate the Gateway Hotel and the Midland Hotel (another hotel owned by Frudential). Gateway Corp. was required by Prudential to provide financial reports on the Gateway Hotel's operations. The full-time employment of personnel to

perform these and other required services would have been uneconomical, since Gateway Corp. would be managing only one or two hotels. Therefore, Eulich agreed that employees of Eulich-Management would provide these services for Gateway Corp.

Eulich, Kanter, and Connolly also formed the Essex partnership (organized effective January 1, 1982). Eulich-Management held a 47.5-percent interest in Essex, Connolly a 5-percent interest, and Kanter's entities IRA and Holding Co. held the remaining 47.5 percent (26.125 percent and 21.375 percent, respectively).

The Essex partnership entered into "Representation and Marketing" agreements with Eulich-Management and Gateway Corp., effective January 1, 1982. The Eulich-Management/Essex agreement required Eulich-Management to pay to Essex 30 percent of its management fees from its operation of the Madison Hotel and 43 percent of the fees from its operation of the Allentown Hilton. The Gateway Corp./Essex agreement required Gateway Corp. to pay to Essex 75 percent of Gateway Corp.'s management fees from the operations of the Gateway Hotel and the Midland Hotel.

The Essex partners agreed that Gateway Corp. and Eulich Management generally would pay the same amount of fees to the Essex partnership. The partnership's specified percentage of fees under each consulting and fee participation agreement could be adjusted and modified if a significant change occurred with respect to the compensation that Gateway Corp. or Eulich-Management received under a particular hotel management contract. Substantially all of Essex's income came from Gateway Corp. and Eulich-Management.

From 1982 to 1988, Essex received $1,334,601 in commission fee payments from Gateway Corp. and $1,563,412 from Eulich-Management. In 1989, Essex received a total of $293,261 from Eulich-Management and Gateway Corp. From 1982 to 1989, Essex distributed $788,452 to IRA, $645,028 to

Holding Co., $150,899 to Connolly, and $1,433,551 to Eulich-Management.

IRA accumulated the money paid to it by Essex until 1983. In 1983, IRA began distributing the money to Ballard, Lisle, and Kanter through Carlco, TMT, and BWK, Inc., in the 45-45-10 ratio. On December 31, 1984, IRA transferred its partnership interest in Essex to Carlco, TMT, and BWK, Inc., in the 45-45-10 ratio. IRA did not inform the Essex partnership of the transfer and continued to receive the payments from Essex and then transferred the payments to Carlco, TMT, and BWK, Inc.

Essex had no real business purpose. It had no office, equipment, or employees and did not perform any services under the "Representation and Marketing" agreements with Eulich-Management and Gateway Corp.

Eulich's relationship with Ballard, Lisle, and Kanter was longstanding. Lisle's son was employed by one of Eulich's Vantage companies. The Court is convinced that Eulich agreed that Eulich-Management would participate in the Essex arrangement and provide services to Gateway Corp. as payment to Kanter, Lisle, and Ballard for their influence with respect to other business directed to Eulich and his corporations. Eulich testified at trial that he caused Eulich-Management to participate in the Essex partnership because he expected that Kanter might eventually help Eulich-Management obtain management contracts for larger hotels.

Although Connolly was an excellent hands-on hotel manager, he had no experience with the financial or reporting aspects of managing a hotel. He participated in the formation of Gateway Corp. and Essex and the financial arrangement because he wanted more money than he had been receiving from the company managing the Gateway Hotel. His participation in this activity was solely at the direction of Ballard, Lisle, and Kanter. Connolly was nothing more than a pawn of Kanter, Ballard, and Lisle.

Employees of Eulich-Management performed record-keeping and reporting services for Gateway Corp., but

Eulich-Management did not charge Gateway Corp. for these services. At least 50 percent of the money received by the Essex partnership came from Eulich-Management, which in turn received only 47.5 percent of the distributions. Under the arrangement, there was no way Eulich-Management could ever make a profit by participating in the Essex arrangement. IRA and Holding Co., on the other hand, never contributed any money to the Essex partnership and never provided any services to Gateway Corp. or the Essex partnership, yet together IRA and Holding Co. received 47.5 percent of the distributions from Essex.

Eulich-Management received back in the form of partnership distributions most of the payments it made to Essex. The net effect was that 75 percent of the management fees Prudential paid to Gateway Corp. was distributed through Essex to Holding Co. and IRA, and finally to Kanter, Ballard, and Lisle. The "Representation and Marketing" agreements thus merely served to disguise payments from the operation of the Gateway and Midland hotels to Kanter, Ballard, and Lisle.

The income to IRA was offset with losses reported on its consolidated return. The entire convoluted arrangement served to conceal Kanter, Ballard, and Lisle's interest in the operations of the hotels from Prudential and to avoid tax.

As with payments made by other members of the Five to IRA, the payments were accumulated in IRA until the formation of Carlco, TMT, and BWK Inc. The funds accumulated in IRA were distributed in the 45-45-10 ratio to Carlco, TMT, and BWK, Inc., and thus, distributed to Lisle, Ballard, and Kanter. The record does not show that the payments made to Holding Co. were distributed to anyone other than Kanter. On the basis of the evidence clearly established in the record, we conclude that Kanter, Ballard, and Lisle agreed that Kanter would receive for his services 100 percent of the Essex payments made to Holding Co. and 10 percent of the Essex payments made to IRA and that Ballard and Lisle each would receive for their services 45

percent of the Essex payments made to IRA.

6. Conclusion

At trial, all the witnesses associated with the Five explicitly denied that the payments described were "kickbacks" or "payoffs" for Ballard and/or Lisle's help in steering business to them. Those witness did confirm, however, that they entered into these arrangements in exchange for Kanter's influence in obtaining business. Furthermore, it is clear from the record that Kanter, Ballard, and Lisle agreed to share and did share the money from the Prudential transactions in a 45-45-10 split.

Although some of the Prudential payments and transactions were finalized after Ballard and Lisle left Prudential, the transactions began long before Ballard and Lisle left Prudential. The payments had their genesis in transactions with which Ballard and Lisle were both familiar and in which they were directly or indirectly involved while they held executive positions with Prudential. The transactions, even if occurring after Ballard and Lisle left Prudential, were simply a continuation of what was laid out and planned in earlier years.

Thus, we find that 70 percent of the payments from Hyatt to KWJ Corp., all of the payments by Frey to Zeus, all of the payments from Schaffel connected with Prudential transactions and made to IRA, the bargain element in the sale of the Schnitzer-PMS stock to IRA, and all of the Essex distributions to IRA are attributable to services provided by Ballard, Lisle, and Kanter. We further find that the payments made by Frey to Holding Co., the payments made by Schaffel to IRA and Holding Co. from transactions not involving Prudential, and the distributions from Essex to Holding Co. are attributable solely to services provided by Kanter.

B. Overview of the Law

Gross income includes all income from whatever source derived. See sec. 61(a). The principle that income is taxed to the person who earned it is basic to our income tax system.

See United States v. Basye, 410 U.S. 441, 450, 93 S.Ct. 1080, 35 L.Ed.2d 412 (1973); Commissioner v. Culbertson, 337 U.S. 733, 739- 740, 69 S.Ct. 1210, 93 L.Ed. 1659 (1949); Lucas v. Earl, 281 U.S. 111, 115, 50 S.Ct. 241, 74 L.Ed. 731 (1930). In United States v. Basye, supra at 450, the Supreme Court stated: "The principle of Lucas v. Earl, that he who earns income may not avoid taxation through anticipatory arrangements no matter how clever or subtle, has been repeatedly invoked by this Court and stands today as a cornerstone of our graduated income tax system". (Emphasis supplied.)

No device or arrangement, no matter how shrewdly or cunningly contrived, can make earnings from personal services taxable to anyone other than the real earner. This principle has been applied to various income-splitting devices, e.g., anticipatory assignments of income to family members (Lucas v. Earl, supra); family trusts (Helvering v. Clifford, 309 U.S. 331, 60 S.Ct. 554, 84 L.Ed. 788 (1940)); family partnerships (Commissioner v. Tower, 327 U.S. 280, 66 S.Ct. 532, 90 L.Ed. 670 (1946); Lusthaus v. Commissioner, 327 U.S. 293, 66 S.Ct. 539, 90 L.Ed. 679 (1946); Commissioner v. Culbertson, supra; Alexander v. Commissioner, 194 F.2d 921 (5th Cir.1952)); and shareholder- corporation arrangements (Gregory v. Helvering, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935); Griffiths v. Commissioner, 308 U.S. 355, 60 S.Ct. 277, 84 L.Ed. 319 (1939); Higgins v. Smith, 308 U.S. 473, 60 S.Ct. 355, 84 L.Ed. 406 (1940); Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943); Commissioner v. Court Holding Co., 324 U.S. 331, 65 S.Ct. 707, 89 L.Ed. 981 (1945)).

If, as in these cases, the issue involves income paid to corporations, we encounter the important policy of the law favoring recognition of a corporation as a legal person and economic actor. If corporations are formed for substantial business purposes, or are actually engaged in substantial business activities, the corporate forms must be recognized for tax purposes. See Moline Properties, Inc. v. Commissioner, supra. On the other hand, if the subject

entities are unreal or shams, the corporate form must be disregarded for tax purposes. See Higgins v. Smith, supra. A finding that a corporation is a sham allows the Commissioner to disregard the corporation altogether for tax purposes. See Haberman Farms, Inc. v. United States, 305 F.2d 787 (8th Cir.1962); James Realty Co. v. United States, 280 F.2d 394 (8th Cir.1960). A finding that a corporation is not a sham, however, does not preclude reallocation under the assignment of income doctrine. It is still possible that a taxpayer could assign the receipt of income earned to a viable corporation in an attempt to avoid the tax liability for that income. This would violate the general principle that income is taxable to the person who earns it. See United States v. Basye, supra at 449-450; Helvering v. Horst, 311 U.S. 112, 119, 61 S.Ct. 144, 85 L.Ed. 75 (1940); Lucas v. Earl, supra at 114-115. Additionally, section 482 authorizes the Secretary to apportion or allocate income between organizations controlled by the same interests if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations.

1. Sham Corporations

Respondent asserts that IRA, its subsidiaries Carlco, TMT, and BWK, Inc., and Holding Co. were sham or dummy corporations that should not be recognized as separate taxable entities. We agree.

Although taxpayers have the right to mold their business transactions in such a manner as to minimize the incidence of taxation, United States v. Cumberland Pub. Serv. Co., 338 U.S. 451, 70 S.Ct. 280, 94 L.Ed. 251 (1950), the Government is not required to acquiesce in the form chosen by taxpayers for doing business. If the form is unreal and a sham, the fiction may be disregarded for purposes of the tax statutes. See Higgins v. Smith, supra; Gregory v. Helvering, supra . The question whether a corporation is genuine or a sham is one of fact. See Noonan v. Commissioner, 451 F.2d 992, 993 (9th Cir.1971), Shaw Constr. Co. v. Commissioner, 323 F.2d 316,

321 (9th Cir.1963).

In Moline Properties, Inc. v. Commissioner, supra at 438-439, the Supreme Court established the following test for determining whether a corporation will be recognized as a separate taxable entity:

The doctrine of "corporate entity" fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid, or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a "separate taxable entity". * * * [Fn. refs. omitted.]

Thus, if the corporations were organized for substantial business purposes, or actually engaged in substantial business activities, their corporate forms must be recognized for tax purposes.

To be recognized, a corporation must be organized for a substantial "business" purpose in the ordinary meaning. See National Investors Corp. v. Hoey, 144 F.2d 466, 468 (2d Cir.1944). "[E]scaping taxation is not 'business' in the ordinary meaning". Id. Thus, a corporation organized for the purpose of avoiding tax is not organized for substantial business purposes.

It is clear from the evidence in these cases that the multiple corporations, as well as the trusts and partnerships, organized by Kanter were not organized for any substantial business purpose but were organized primarily to obtain tax benefits.

Kanter routinely created "shelf" corporations that remained inactive until he needed a vehicle to channel payments from his various schemes. At trial, Kanter admitted that Carlco, TMT, and BWK, Inc., were "shelf" corporations. Thus, any business purposes set forth in the articles of incorporation were merely gestures without substance.

Furthermore, Kanter routinely created various corporations,

partnerships, and trusts with similar names; for example, Cedilla Co ., Cedilla Investment Co., Investment Research Associates, Ltd. (formerly Cedilla Co.), Cedilla Co. (formerly Arba Investments Inc.), and Cedilla Trust; KWJ Corp. and KWJ Co. partnership; Essex Corp. and Essex Partnership. As a result of the intended confusion created by similar names, Kanter could substitute one entity for another. For example, after KWJ Corp. was liquidated, the payments from Hyatt to KWJ Corp. were simply treated as payments to the KWJ Co. partnership. Hyatt never knew about the change until about 1992.

Moreover, assuming IRA's predecessor Cedilla Co. (Old Cedilla Co.) had been incorporated for the purpose of brokering real estate (a valid business purpose [FN48]), we cannot attribute the purpose for the formation of Old Cedilla Co. to IRA. Originally, Keating owned the common stock of Old Cedilla Co., and Schott owned the preferred class A preferred stock.

In 1975, the same year Weaver agreed to sell KWJ Corp. to Kanter, Keating's 1,000 shares of common stock of Old Cedilla Co. were exchanged for 500 shares of class B preferred stock, [FN49] and Weisgal as trustee of the Bea Ritch trusts acquired 1,000 shares of the common stock. Schott continued to hold the class A preferred stock in Old Cedilla Co. to enable Old Cedilla Co. to qualify for a corporate broker's license.

In 1978, Old Cedilla Co.'s name was changed to IRA. When Old Cedilla Co.'s name changed, IRA acquired 1,000 shares of Arba and changed the name of Arba to Cedilla Co (New Cedilla Co.). IRA's end of year balance sheet indicates that IRA's 1,000 shares of Cedilla Co. were the only shares outstanding.

In 1983, IRA made a journal entry to show that IRA redeemed Schott's 500 shares of IRA class B preferred stock in exchange for IRA's 1,000 shares of its Cedilla Co. stock. Schott thought that, when Cedilla Co.'s name was changed to IRA, she acquired another company and the name of that

corporation was changed to Cedilla Co. She did not know that she had owned any of the stock of IRA after the name change. She testified that she owned New Cedilla Co. and that she conducted her real estate brokerage business individually as well as through IRA and New Cedilla Co. The name change occurred in 1978, the same year IRA purchased the stock of Schnitzer-PMS and the payments to IRA related to the Prudential transactions began. In 1979, when IRA acquired the stock of KWJ Corp., Schaffel began splitting commissions with Kanter, and Century repurchased IRA's Schnitzer-PMS stock. When Cedilla Co.'s name was changed to IRA, whatever the purpose Cedilla Co. was originally formed to pursue, it is evident that purpose went along with the name to a new Cedilla Co.

We find that the corporations and entities were not organized for any valid business purposes.

A corporation is not treated as carrying on a business merely because it engages in certain corporate formalities, such as holding corporate meetings, adopting bylaws, electing officers and directors, issuing securities and keeping separate books. See Aldon Homes, Inc. v. Commissioner, 33 T.C. 582, 600-601, 1959 WL 972 (1959). In order to be treated as carrying on a business, in addition to engaging in corporate formalities, the corporation must hold itself out to unrelated third parties and engage in substantial business activities. See Skarda v. Commissioner, 250 F.2d 429, 434-435 (10th Cir.1957), affg. 27 T.C. 137, 1956 WL 558 (1956). Further, a corporation is not treated as carrying on a business if its activities, such as executing contracts and filing tax returns, are merely "empty gestures" rather than substantial transactions. Kimbrell v. Commissioner, 371 F.2d 897, 901-902 (5th Cir.1967), affg. T.C. Memo.1965-115.

The following factors lead us to the conclusion that IRA did not carry on any business.

We first observe that the original Cedilla Co. paid minimal salaries or wages in 1977 ($986) and 1978 ($5,051). After the name change in 1979, IRA paid minimal salaries or wages

only in 1981 ($9,969), and 1982 ($26,079) and paid no salaries or wages in any other year. In fact, there is no evidence that IRA had any employees other than bookkeepers who also performed bookkeeping services for the multitude of other Kanter entities. Although the original Cedilla Co. paid substantial commissions and consulting fees from 1976 to 1979, after the name change, IRA paid commissions only in 1981 ($115,400) and in 1985 ($4,000) and paid consulting fees only in 1982 ($29,000).

The original Cedilla Co. paid officer's fees in 1977 ($19,300) and 1978 ($15,000). After the name change, IRA did not pay any officer's or director's fees (except the $12,500 payment made to Ballard).

Furthermore, there is no evidence that the commissions, consulting fees, officer's fees, or director's fees were properly characterized as such payments or paid for services provided to the corporations. For example, petitioners assert that Ballard was never a director of IRA and that the $12,500 payment to Ballard was not in fact a director's fee. KWJ Corp. and KWJ Co. partnership paid Ballard's and Lisle's children consulting fees, yet the children never provided any services for the payments.

Additionally, there is no evidence that any of IRA's income was attributable to Schott's real estate activity. Schott could not remember exactly what she did for IRA. She merely signed documents without any real knowledge of the transactions involved. When IRA redeemed Schott's 500 shares of IRA class B preferred stock in 1983, IRA no longer qualified to hold a corporate broker license.

The payments of development fees from Frey and the BJF partnership were not related to any investment IRA and Holding Co. may have made in any of Frey's condominium conversion projects.

We conclude that the corporations did not carry on substantial business activity in the ordinary meaning.

Finally, even if we were able to find some modicum of business activity, petitioners and other parties to the various

transactions did not recognize any of the corporations or entities as valid separate entities or true parties in interest to the various transactions. Some of the individuals involved in the transactions with Kanter had never heard of IRA, and those that had, considered IRA to be Kanter.

Around 1992, Kanter attempted to have Hyatt send the payments to the KWJ Co. partnership instead of to Weaver. While Kanter provided Hyatt with documents showing that KWJ Corp. had been sold to IRA, liquidated, and the contract rights assigned to KWJ Co. partnership, Hyatt refused to do so without Weaver's consent, which had not been attained at the time of trial. Hyatt continued to send the payments to Weaver.

After Lisle began working for Travelers, although Schaffel's agreement was purportedly with IRA, he sent payments from Travelers deals to Holding Co. If IRA, rather than Kanter, had been the true party in interest and had been Kanter's client, the payments for the Travelers deals would have been paid to IRA.

A comparison of the business records of IRA, Administration Co., Int'l Films, Holding Co., and HELO illustrates the sham nature of the entities. Kanter completely controlled IRA, Holding Co., Administration Co., HELO, Int'l Films, and the various trusts. He had unrestricted power over the commingled funds and was in a position to determine and direct the payments from outside sources to the various entities. He routinely used the funds for his own benefit. He routinely shifted accounts between entities with no documentation to establish a rationale for such transfers. He created phony loans that were eventually written off, and then he or the corporations took bad debt deductions to offset additional income.

Similarly, Lisle, Ballard, and Kanter failed to recognize any separate identity of Carlco, TMT, and BWK, Inc. Petitioners assert that Lisle, Ballard, and Kanter were only the respective managers of the assets of Carlco, TMT, and BWK, Inc., and claim that the preferred stock issued to their family

trusts had minimal value. The record clearly shows, however, that petitioners' control over the assets of the corporations went far beyond that of a manager. Petitioners used the funds for their personal benefit. From 1984 to 1986, Ballard transferred $16,599 to himself that was recorded as a receivable on TMT's books. In 1987, Ballard transferred the St. Francis Arkansas land owned by TMT to himself and recorded the transfer as a sale. He did not pay for the land but recorded a receivable of $100,000 as owed by him on TMT's books. In 1987, TMT funds also were used to pay $20,344 to the Fairfield Plantation Company, Ballard's S corporation. The payment was recorded as a receivable owed by Ballard. In 1989, Ballard distributed $10,000 to himself from TMT and increased his receivable to $146,943. In addition, Ballard distributed $160,000 of TMT's funds to his wife, $122,900 to the Seabright Trust, $10,080 to the Seabright Corp., all recorded as receivables. Ballard distributed $19,000 to Ficom (Melinda Ballard's sole proprietorship) that TMT later wrote off as a worthless investment. Ballard and his wife referred to farms owned by TMT as their farms.

Kanter took $400,000 out of BWK, Inc. and recorded the distribution as a receivable. Lisle used $3,000 of Carlco's funds to pay a receivable on the books of Administration Co. The payment did not create a receivable on Carlco's books. When receivables were recorded for funds taken out of the corporations, there was no intention or expectation that the funds would be repaid, and there was never any attempt to collect the receivables until the IRS began auditing petitioners' returns.

Petitioners used the corporations' partnership, KWJ Co., to distribute money to the Ballard and Lisle children in the guise of consulting fees. The children never performed any services for the payments.

Petitioners maintained possession of the corporations' assets and records. The addresses given for Carlco and TMT were the addresses of Lisle's and Ballard's residences. When Lisle

lived in Connecticut, the records were maintained in Connecticut; when he moved to Texas, the records and accounts were maintained in Texas.

Ballard and Lisle gave family members signatory authority over the corporate accounts. Mary Ballard had signatory authority over TMT's Wells Fargo Bank account. Donna Lisle and Lisle's brother had signatory authority over Carlco's Goldman Sachs account. Donna Lisle had signatory authority over Carlco's North Dallas bank account.

Petitioners assert that the only interest they had in Carlco, TMT, and BWK, Inc., was the preferred stock issued to the family trusts and that the stock had minimal value. The certificates of incorporation of Carlco, TMT, and BWK, Inc. authorized each corporation to issue 1,000 shares of 10-cent par value common stock. Certificates of amendment, filed in December 1983, authorized the corporations to issue 11,000 shares of stock comprised of 10,000 shares of 1- cent par value preferred stock and 1,000 shares of 10-cent par value common stock. The amended certificates granted each corporation's board of directors authority to fix the preferences of the preferred shares. The record does not contain any evidence of resolutions by the board of directors of any of the three corporations setting preferences or limitations on the preferred stock.

Petitioners point to the following preferences and other characteristics printed on the back of the stock certificates to support their assertion that the preferred stock of Carlco, TMT, and BWK, Inc. issued to the family trusts had minimal value:

1. One vote per share.

2. Dividends payable only when, if, and as declared at a maximum rate of 10 percent per annum after 1990. Dividends are non-cumulative.

3. Redemption by company at any time upon 10 days notice at 105 percent. 4. Priority on liquidation equal to original purchase price per share.

5. Shares are not convertible into common stock.

Petitioners claim that the certificates prove that the preferred shares could not be worth more than approximately $1,650, which could only be realized upon liquidation or upon redemption of the shares. We disagree. First, in their briefs, petitioners inserted "of par" into the redemption rights to read "Redemption by company at any time upon 10 days notice at 105 percent of par." The preferred stock could instead be redeemable for 105 percent of, e.g., the retained earnings. Similarly, with respect to liquidation rights, "priority on liquidation equal to original purchase price per share" is also subject to multiple interpretations. The shares could be entitled to the original purchase price first but also allowed to share with the common stock in the remaining assets. Original purchase price could include a value set for the uncompensated services of the manager (Ballard, Lisle, and Kanter). That value could be tied to the retained earnings of the corporations or at an annual amount. Without a resolution by the board of directors setting forth preferences, we find the preferences reflected on the certificates to be ambiguous. Petitioners failed to produce any corporate resolution. We can only 'nfer that the resolutions contradict petitioners' assertions. Finally, the record establishes that Kanter was not restrained by corporate formalities including preferences, stock ownership, asset ownership, etc.

Kanter claims that Carlco's preferred stock was issued to Lisle's family trust to give Lisle more control and discretion with respect to Carlco's investments. We fail to see how stock that does not have voting control could provide such control or discretion with respect to the assets of the corporations. Lisle, Ballard, and Kanter, respectively, had unrestricted control of the assets of Carlco, TMT, and BWK, Inc. We think that fact is a strong indicator of the true owners of the assets.

On the basis of the record before us, we conclude that Kanter personally diverted payments of compensation, including those made by the Five for his, Ballard's, and Lisle's services

and influence, through IRA, Holding Co., and their subsidiaries. Petitioners formed and utilized all the corporations as a way to conceal their true income for the years at issue. The record is clear that petitioners used all of these accounts as parts of incorporated or unincorporated pocketbooks. The corporations whose names were on the various accounts did not earn the taxable amounts attributed to those accounts.

A taxpayer cannot expect the Commissioner to recognize the separate identity of an entity where the taxpayer himself so blatantly ignores any separate existence. Nor should the courts require the Commissioner to do so.

On the record presented to us, we find that IRA, Holding Co., their subsidiaries, including Zeus, Zion, Carlco, TMT, and BWK, Inc. did not carry on any business and were only the alter egos of Kanter, Lisle, and Ballard. We find the various entities to be pure tax avoidance vehicles. The corporations were nothing more than a few incorporating papers of no significance except when a tax return was due. Petitioners diverted millions of dollars of income. The make-believe corporations were shams and too transparent to accept for tax purposes.

2. Assignment of Income

Even if the corporations that received the payments from the Five had been viable entities, that would not preclude application of the assignment of income doctrine, as a taxpayer could assign income to a corporation that conducts real and substantial business in an attempt to avoid tax. See Haag v. Commissioner, 88 T.C. 604, 611, 1987 WL 49288 (1987), affd. without published opinion 855 F.2d 855 (8th Cir.1988).

Gross income means all income from whatever source derived, including compensation for services, including fees, commissions, and similar items. See sec. 61(a)(1).

Compensation for services is an item of gross income that cannot be effectively assigned to escape the burden of taxation. See Lucas v. Earl, 281 U.S. at 114-115. This Court has upheld reallocations of income from a validly organized

and operated corporation to its shareholder/employee under the assignment of income doctrine. See Bagley v. Commissioner, 85 T.C. 663, 1985 WL 15405 (1985), affd. 806 F.2d 169 (8th Cir.1986); Askew v. Commissioner, T.C. Memo.1985-100, affd. 805 F.2d 830 (8th Cir.1986).

Respondent cites DeVaughn v. Commissioner, T.C. Memo.1983-712, as an example of a similar situation in which the assignment of income doctrine was applied to tax kickback payments to an individual taxpayer who had earned the payments but sought to redirect them to that taxpayer's corporation.

In cases involving viable corporations, we consider all the facts and circumstances to determine the actual earner of income. See Schuster v. Commissioner, 800 F.2d 672 (7th Cir.1986), affg. 84 T.C. 764, 1985 WL 15343 (1985); Fogarty v. Commissioner, 780 F.2d 1005 (Fed.Cir.1986), affg. 6 Cl.Ct. 612 (1984); Leavell v. Commissioner, 104 T.C. 140, 155, 1995 WL 33308 (1995). In determining the proper taxpayer, we consider which person or entity controls the earning of the income, such as:

(1) Whether the individual rather than the corporation or entity that received the income, in fact, controlled the earning of the income, see Vercio v. Commissioner, 73 T.C. 1246, 1980 WL 3859 (1980);

(2) whether the individual performed the services as an agent or employee of the corporation, see Rubin v. Commissioner, 51 T.C. 251, 1968 WL 1522 (1968);

(3) whether the corporate form and the status of the corporation as an actual operating enterprise have been recognized by petitioners;

(4) whether the corporate form and the status of the corporation as an actual operating enterprise have been recognized by the other parties to the transactions giving rise to the income;

(5) whether the form of the transaction served an economic purpose, see Rubin v. Commissioner, supra; and

(6) whether the corporations were formed for the purpose of taking advantage of losses incurred by a separate trade or

business.

The record shows that Kanter was in control of negotiations concerning the amount of commissions and that he earned those commissions by performing the work for them. He directed members of the Five where to make payments. The various entities were entirely subject to Kanter's control: he set up the entities, and he managed the entities in that Meyers, Schott, Weisgal, and Freeman were subject to his control. There is no evidence that IRA, Holding Co., or any of the other entities earned these funds. Petitioners handled the accounts as if they were their own, moving funds around from location to location and using the funds for their personal benefit. This is hardly the behavior that petitioners would exhibit if the funds in the accounts were subject to the control of Weisgal or the various entities.

Kanter did virtually all of the planning and implementing of the transactions. The officers, directors, and trustees signed documents and entered transactions as Kanter directed including issuing and redeeming stock, liquidating corporations, purchasing and selling stock, distributing funds, and executing contracts and agreements. There is very little evidence that IRA or the other entities had anything to do with these transactions other than to be the named recipients of the checks.

Lastly, we note that payments to IRA were distributed to the accounts of Carlco, TMT, and BWK, Inc. of which petitioners and their family members were authorized signatories. If, as petitioners contend, the funds of the corporations did not belong to them, they would have been misappropriating the funds through phony loans. Therefore, we conclude that petitioners were simply using the corporations to receive the funds they had earned. Regardless of where the funds actually went, they were earned primarily through the efforts of petitioners via their contacts with Prudential, Travelers, and the Pritzker family.

In Rubin v. Commissioner, supra, we found that the income was properly taxable to the individual who performed the

services for which payment was made where the individual was not contractually bound to (and in fact did not) render services exclusively to a personal service corporation. In these cases, petitioners were not contractually bound to, nor did they render services for, the corporations.

Ballard, Lisle, and Kanter were not employees of any of the corporations or entities involved in the transactions at issue. Ballard and Lisle were full- time employees of Prudential, Travelers, or Goldman-Sachs. Kanter was a self- employed attorney.

Kanter was not an agent of the corporations. In fact, there is evidence that Kanter in some instances held himself out to members of the Five (in particular Schaffel) as Ballard's and Lisle's agent, referring to them as his "associates". Ballard and Lisle did not claim that they were agents of IRA or any other entity (except to justify the payment Ballard received as a director's fee from IRA while denying he was ever a director).

We have previously discussed the failure of petitioners and other parties to the transactions to recognize the separate existence of the corporations. None of the Five recognized any of the corporate entities as controlling petitioners' performance of services. Even though the payments were made to various corporations, it is clear that the other parties to the transactions viewed IRA, Holding Co., their subsidiaries, and Kanter as one and the same. Although the various agreements at issue were between members of the Five and IRA, Holding Co., or one of their subsidiaries, the record shows that there was virtually no involvement in these arrangements by those corporations; rather, they were agreements with the corporations in name only.

Additionally, assuming IRA was not a sham corporation, the purchase of the KWJ Corp. stock was merely a device to hide the stream of income and accumulate the funds. The transaction itself was a sham. Similarly with the purchase of the Schnitzer-PMS stock, Schnitzer would have sold the stock directly to Kanter. He sold it at a bargain price for

Kanter's services, not for any services from IRA, Weisgal, or Schott. It is also clear from the flow of the installment payments on Schnitzer's repurchase of the stock that IRA either held the stock merely as a nominee for Kanter, Ballard, and Lisle, or agreed to pay the money it received from the Schnitzer-PMS transaction to Ballard, Lisle, and Kanter in exchange for their assistance in giving more Prudential business to Schnitzer- PMS. The increase in the Prudential business greatly increased the pretax income and, thus, the value of the Schnitzer-PMS stock. Hence the gain was attributable to their services. IRA held the profits for the benefit of Ballard, Lisle, and Kanter until it distributed the funds to them through Carlco, TMT, and BWK, Inc. The record is replete with examples of interests that were owned initially by Kanter or an entity and then later declared to have been held by Kanter or the entity as "nominee" for someone else. Thus, we hold that the gain on the sale of the stock is properly taxable to Kanter, Ballard, and Lisle.

The use of numerous corporations was to facilitate the concealment of the payments, and such use was further motivated by the tax benefits to be derived therefrom and for no sound business purpose.

We conclude that the transactions at issue are classic situations for the application of the assignment of income doctrine articulated in Lucas v. Earl, 281 U.S. 111, 115, 50 S.Ct. 241, 74 L.Ed. 731 (1930), and its progeny. The amounts received by the corporations were for services rendered by petitioners to the Five and should be includable in their income under section 61. See United States v. Basye, 410 U.S. 441, 450, 93 S.Ct. 1080, 35 L.Ed.2d 412 (1973).

3. Section 482

Finally, even if the corporations had been viable entities, we do not think respondent's reallocation under section 482 was unreasonable, arbitrary, or capricious.

Section 482 authorizes the Secretary to apportion or allocate income between organizations controlled by the same interests if he determines that such distribution,

apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations. The relevant regulation explains that the purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, and to ensure that controlling entities conduct their subsidiaries' transactions in such a way as to reflect the "true taxable income" of each controlled taxpayer. Sec. 1.482-1A(b)(1), Income Tax Regs. [FN50]

In order to justify a reallocation under section 482, the Commissioner must find (1) that there are two or more trades, businesses, or organizations, (2) that such enterprises are owned or controlled by the same interests, and (3) that the reallocation is necessary to allocate income among the two or more enterprises in order to prevent evasion of taxes or to properly reflect each enterprise's income. See B. Forman Co. v. Commissioner, 453 F.2d 1144, 1152 (2d Cir.1972), affg. in part, revg. in part 54 T.C. 912, 1970 WL 2219 (1970).

Section 482 was intended to apply and has been applied to cases where the profits of one business have been offset against the losses of another to reduce or escape tax liability. See Ach v. Commissioner, 42 T.C. 114, 1964 WL 1353 (1964), affd. 358 F.2d 342 (6th Cir.1966).

In these cases, there was shifting of profits from one business to another (from petitioners to the various Kanter entities); thus the primary evil that section 482 was designed to prohibit is present. We hold that respondent's reallocation under section 482 was not unreasonable.

4. Conclusion

We have found that 70 percent of the payments from Hyatt to KWJ Corp., all of the payments by Frey to Zeus, all of the payments from Schaffel to IRA, the bargain element in the sale of the Schnitzer-PMS stock to IRA, and all of the Essex distributions to IRA are attributable to services provided by Ballard, Lisle, and Kanter. We further have found that the gain on the sale of the Schnitzer-PMS stock was properly taxable to Ballard, Lisle, and Kanter. Additionally, the

interest income earned on the payments is also properly taxable to Ballard, Lisle, and Kanter. Finally, we have found that the payments by Frey to Zion, the payments by Schaffel to Holding Co, and the distributions from Essex to Holding Co. are attributable to services provided by Kanter.

In addition, we have found that the corporations were shams, and, even if the corporations had been viable entities, petitioners were the true earners of the income, and respondent's allocation under section 482 was not unreasonable, arbitrary, or capricious.

With respect to 70 percent of the payments from Hyatt to KWJ Corp ., all of the payments by Frey to Zeus, all of the payments from Schaffel to IRA, the bargain element in the sale of the Schnitzer-PMS stock to IRA, as well as the gain and interest on the repurchase of the stock, and all of the Essex distributions to IRA, we think the 45-45-10 split is clearly evident. Thus, we hold that the payments, bargain element, gain, and interest are taxable 45 percent to each of Ballard and Lisle and 10 percent to Kanter.

IRA acquired 47.5 percent of the common stock of Schnitzer-PMS Corp. with a value of roughly $522,500 for $150,000. We hold that the bargain element is $372,500 ($522,500--$150,000) and the gain on the sale is $2,577,500 ($3.1 million--$522,500). The gross profit ratio is 83.15 percent ($2,577,500 divided by $3.1 million).

IRA received the following payments of principal and interest on the installment sale of the Schnitzer-PMS Corp. stock:

Year	Payment	Principal	Interest
1979	$150,000	$150,000	--
1980	533,425	211,468	$321,957
1981	534,696	309,308	225,388
1982	361,692	172,441	189,251
1983	361,692	186,655	175,037
1984	361,692	202,042	159,650

1985	361,692	218,696	142,996
1986	361,692	236,724	124,968
1987	361,692	256,217	105,475
1988	361,692	277,360	84,332
1989	840,423	822,841	17,582
Total	4,590,388	3,043,752	1,546,636

The gain on the sale is computed as follows:

Year	Principal	Profit Ratio	Gain
1979	$150,000	.8315	$124,725
1980	211,468	.8315	175,836
1981	309,308	.8315	257,190
1982	172,441	.8315	143,385
1983	186,655	.8315	155,204
1984	202,042	.8315	167,998
1985	218,696	.8315	181,846
1986	236,724	.8315	196,836
1987	256,217	.8315	213,044
1988	277,360	.8315	230,625
Total			1,846,689

In 1989, IRA accepted $822,841 as the final principal payment, reducing the selling price to the total principal payments of $3,043,752. For purposes of computing the 1989 gain, adjusted gross profit on the sale is reduced to $2,521,252 ($3,043,752--$522,500). Thus, the gain recognized in 1989 is $674,563 (the adjusted gross profit $2,521,252 less the $1,846,689 gain recognizable in prior years).

The payments related to these transactions paid by the Five to IRA and its subsidiaries during the years 1978 through 1989 were as follows:

Schnitzer-PMS

Year Hyatt Schaffel Frey Essex Bargain Gain Interest Total
---- ------- -------- -------- ------- ------------------------ ---------

1977 $38,394 - - - - - - $38,394
1978 42,517 - - - $372,500 - - 415,017
1979 119,719 $100,000 - - - $124,725 - 344,444
1980 - 244,920 $127,372 - - 175,836 $321,957 8 70,085
1981 90,070 361,525 105,764 - - 257,190 225,388 1,039,937
1982 172,702 447,450 538,781 $86,212 - 143,385 189,251
1,577,781
1983 172,090 30,981 110,125 78,375 - 155,204 175,037 721,812
1984 186,092 - 103,500 133,238 - 167,998 159,650 750,478
1985 206,790 - 128,763 120,175 - 181,846 142,996 780,570
1986 231,263 - - 80,465 - 196,836 124,968 633,532
1987 229,449 - - 120,698 - 213,044 105,475 668,666
1988 197,348 - - 117,562 - 230,625 84,332 629,867
1989 52,777 - - 51,727 - 674,563 17,582 796,649

The payments related to the Prudential transactions are allocable to Ballard, Lisle, and Kanter in the following amounts for each of the years 1978 through 1989:

Year Total Ballard (45%) Lisle (45%) Kanter (10%)
---- --------- ------------ ---------- ------------
1978 $38,394 $17,277 $17,277 $3,839
1979 415,017 186,758 186,758 41,502
1980 870,085 391,538 391,538 87,009
1981 1,039,937 467,972 467,972 103,994
1982 1,577,781 710,001 710,001 157,778
1983 721,812 324,815 324,815 72,181
1984 750,478 337,715 337,715 75,048
1985 780,570 351,257 351,257 78,057
1986 633,532 285,089 285,089 63,353
1987 668,666 300,900 300,900 66,867
1988 629,867 283,440 283,440 62,987
1989 796,649 358,492 358,492 79,665

With regard to the $213,750 paid by Schaffel to IRA in 1983 related to a Travelers' financing transaction, as well as all payments by the Five to Holding Co, the record does not show that any of these payments were ever distributed to Lisle. We hold that Kanter realized all of the income. Schaffel, Frey, and Essex made the following payments to IRA and Holding Co. during the years 1981 through 1989 that are taxable to Kanter, as follows:

Year Schaffel Frey Essex Total
---- --------- ------- ------- ---------
1981 -- $80,616 -- $80,616
1982 -- -- $70,538 70,538
1983 $213,750 16,200 64,125 294,075
1984 600,000 113,827 109,013 822,840
1985 1,160,000 256,557 98,325 1,514,882
1986 1,003,500 -- 65,835 1,069,335
1987 -- 30,570 98,752 132,322
1988 -- -- 96,188 96,188
1989 -- -- 42,332 42,332

We hold that Ballard's omitted income from the Five for the years before the Court is as follows:

Year Omitted Income
---- --------------
1978 $17,277
1979 186,758
1980 391,538
1981 467,972
1982 710,001
1984 337,715
1987 300,900
1988 283,440
1989 358,492

We hold that Lisle's omitted income from the Five for the

years before the Court is follows:

Year	Omitted Income
1984	$337,715
1987	300,900
1988	283,440
1989	358,492

We hold that Kanter's omitted income from the Five for each of the years before the Court is as follows:

Year	Prudential	Other	Omitted Income
1978	$3,839	--	$3,839
1979	41,502	--	41,502
1980	87,009	--	87,009
1981	103,994	$80,616	184,610
1982	157,778	70,538	228,316
1983	72,181	294,075	366,256
1984	75,048	822,840	897,888
1986	63,353	1,069,335	1,132,688
1987	66,867	132,322	199,189
1988	62,987	96,188	159,175
1989	79,665	42,332	121,997

III. Fraud Additions to Tax and Penalties

A. Positions of the Parties

None of the notices of deficiency issued to Ballard, Lisle, and Kanter determined fraud. At some point in time, respondent saw the need to amend the answers in these cases to assert that petitioners were liable for the fraud additions to tax and penalties and to increase the deficiencies in tax over those determined in the notices of deficiency. The parties and the Court agreed that the amendments to answers would not be filed in each of these cases until the trial commenced on June 13, 1994. Similarly, it was agreed that replies would be filed

at that time. Kanter filed a motion to strike portions of respondent's amendments to answer that alleged increases in deficiencies and fraud with respect to transactions unrelated to payments from the Five.

The Court granted Kanter's motion as follows:

ORDERED that petitioners' motion to strike is granted to the extent of all adjustments in respondent's Amendment to Answer for an increased deficiency in tax and additions to tax as to transactions or events which are not related to or constitute part of the transactions which have been commonly referred to and identified by the parties as the "Prudential Issues" and/or "the Five" and, accordingly, such adjustments and the allegations of such adjustments are hereby stricken from the record of this case and will be excluded from consideration by the Court.

Respondent filed a motion for reconsideration. After a hearing on respondent's motion for reconsideration was held on July 25, 1994, that motion was denied. Ballard and Lisle also filed, and the Court granted, motions to strike portions of respondent's amendments to answer that asserted increases in deficiencies and fraud with respect to transactions unrelated to payments from the Five in their cases. Thus, the issue to be decided is whether Kanter, Ballard, and Lisle are liable for the additions to tax and penalties for fraud related to income from transactions with the Five.

Respondent contends that Kanter, Ballard, and Lisle are liable for the additions to tax and penalties for fraud for the years at issue because they received the income from kickback payments involved in a complex scheme intended to conceal, mislead, or otherwise prevent the collection of taxes.

To the contrary, petitioners contend that they did not receive such income and that respondent has failed to prove by clear and convincing evidence that they are liable for the asserted fraud additions to tax and penalties.

B. Applicable Statutory Provisions

For taxable years 1978 through 1981, section 6653(b) provides for an addition to tax in an amount equal to 50 percent of the underpayment of tax if any part of the underpayment is due to fraud.

For taxable years 1982 through 1985, section 6653(b)(1) provides for an addition to tax in an amount equal to 50 percent of the underpayment of tax if any part of the underpayment is attributable to fraud. Section 6653(b)(2) provides for an addition to tax (in addition to the addition under section 6653(b)(1)) in an amount equal to 50 percent of the interest payable under section 6601 with respect to the portion of the underpayment that is attributable to fraud. For purposes of section 6653(b)(2), interest is computed for the period beginning on the last day prescribed for payment of the underpayment (without regard to extensions) and ending on the earlier of the date of assessment or payment of the tax (the statutory period).

For taxable years 1986 and 1987, section 6653(b)(1)(A) provides for an addition to tax in an amount equal to 75 percent of the portion of the underpayment that is attributable to fraud. Section 6653(b)(1)(B) provides for an addition to tax (in addition to the addition under section 6653(b)(1)(A)) in an amount equal to 50 percent of the interest payable under section 6601 for the statutory period with respect to the portion of the underpayment that is attributable to fraud.

For taxable year 1988, section 6653(b)(1) provides for an addition to tax in an amount equal to 75 percent of the portion of the underpayment that is attributable to fraud. Section 6653(b)(2) provides that, if the Secretary (Commissioner) establishes that any portion of the underpayment is attributable to fraud, the entire underpayment is treated as attributable to fraud, except for any portion that the taxpayer establishes is not attributable to fraud.

For taxable year 1989, section 6663(a) provides for the imposition of a fraud penalty in an amount equal to 75

percent of the portion of the underpayment that is attributable to fraud. Section 6663(b) provides further that, if the Secretary (Commissioner) establishes that any portion of the underpayment is attributable to fraud, the entire underpayment is treated as attributable to fraud, except for any portion that the taxpayer establishes is not attributable to fraud.

C. General Legal Principles Relating to Civil Fraud

The Commissioner bears the burden of proof with respect to the additions to tax and penalties for fraud, and that burden must be carried by clear and convincing evidence. See sec. 7454(a); Rule 142(b); Rowlee v. Commissioner, 80 T.C. 1111, 1123, 1983 WL 14844 (1983).

Respondent must establish each element of fraud by clear and convincing evidence in each of the years at issue. See sec. 7454(a); Rule 142(b); Smith v. Commissioner, 926 F.2d 1470, 1475 (6th Cir.1991), affg. T.C. Memo.1989- 171; Traficant v. Commissioner, 884 F.2d 258, 263 (6th Cir.1989), affg. 89 T.C. 501, 1987 WL 45156 (1987). In view of our order granting petitioners' motions to strike portions of respondent's amendments to answers, respondent must prove by clear and convincing evidence for each of the years in issue (1) the existence of an underpayment of tax each year attributable to transactions related to the Five, and (2) that the underpayment of that tax is due to fraud. However, if respondent establishes that there are underpayments of tax from transactions related to the Five that are attributable to fraud, the amount of the addition under section 6653(b) for 1978 through 1981 and under section 6653(b)(1) for 1982 through 1985 is equal to 50 percent of the entire underpayment of tax, including any portion of the underpayment not related to transactions related to the Five. Additionally, if respondent satisfies his burden for 1988 and 1989, the amount of the addition or penalty is equal to 75 percent of the entire underpayment, unless petitioners establish that any portion of an underpayment (resulting from the other issues decided in

these cases) is not attributable to fraud.

D. Underpayments of Tax

Respondent must first prove by clear and convincing evidence that Ballard, Lisle, and Kanter each underpaid their taxes for each of the years at issue on income attributable to transactions related to the Five.

Section 61(a) defines gross income to include "all income from whatever source derived". In addition, the Supreme Court has determined that gross income includes all " 'accessions to wealth, clearly realized, and over which the taxpayers have complete dominion" ', including illegal earnings. James v. United States, 366 U.S. 213, 219, 81 S.Ct. 1052, 6 L.Ed.2d 246 (1961) (quoting Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431, 75 S.Ct. 473, 99 L.Ed. 483 (1955)); accord Rutkin v. United States, 343 U.S. 130, 137-138, 72 S.Ct. 571, 96 L.Ed. 833 (1952); Ianniello v. Commissioner, 98 T.C. 165, 173, 1992 WL 31236 (1992).

We have held that the payments made by the Five to IRA related to the Prudential transactions are taxable 45 percent each to Ballard and Lisle and 10 percent to Kanter and the remaining payments made to IRA and Holding Co. are taxable 100 percent to Kanter. Our holding is supported by clear and convincing evidence in the record.

Kanter entered into arrangements pursuant to which he would use his business and professional contacts, including his relationship with Ballard and Lisle, to assist members of the Five in obtaining business opportunities or in raising capital for business ventures. In exchange for his services, Kanter received or shared in certain fees. Kanter established a complex organization of corporations, partnerships, and trusts to receive, distribute, disguise, and launder the payments from these arrangements. The payments were made to entities controlled by Kanter and then distributed through various means to Ballard, Lisle, and Kanter, their family members, or to entities established for the benefit of their families.

Eulich, Frey, Schnitzer, and Schaffel (members of the Five

who were involved in the transactions and who testified as witnesses in these cases) each confirmed that they entered into the arrangements in exchange for Kanter's using his business connections and influence to direct business to them. There is no doubt that the payments were made for Kanter's services and, therefore, are income to him. The record clearly shows that out of the payments made to IRA, Kanter agreed to pay (and did pay) to each of Ballard and Lisle 45 percent of the payments related to the Prudential transactions, and that he did not share any of the payments unrelated to the Prudential transactions with Ballard and Lisle or anyone else.

Furthermore, the record establishes beyond any doubt that Ballard and Lisle received the benefit of the payments related to the Prudential transactions. Some of those payments were distributed to them directly or indirectly through their family members and their family trusts. Some of the payments were distributed to Ballard and Lisle through various Kanter-created "sham" entities and were recorded as loan receivables. Others were payments characterized as consulting fees made to their adult children by KWJ Corp. and KWJ Co. partnership.

Kanter entities made the following "loans" to Ballard, his family members, and entities established for the benefit of Ballard's family members:

Ballard Loans

Lender	Year	Distributee	Amount
Int'l Films	1974	CMB Cinema Trust	$10,000
Int'l Films	1975	CMB Cinema Trust	21,500
Int'l Films	1975	CMB Cinema Trust II	12,500
Int'l Films	1976	CMB Cinema Trust	8,200
Int'l Films	1976	CMB Cinema Trust	19,000

Int'l Films 1976 CMB Cinema Trust II 1,100
Int'l Films 1977 CMB Cinema Trust 2,200
Int'l Films 1977 CMB Cinema Trust II 3,400
Int'l Films 1978 CMB Cinema Trust 3,000
Int'l Films 1978 Ballard 9,500
Int'l Films 1979 Ballard 8,784
HELO 1980 Summit Trust 85,000
HELO 1981 Summit Trust 20,700
Int'l Films 1981 CMB Cinema Trust 4,000
IRA 1982 Ballard 160,400
IRA 1983 Ballard 500
Administration Co. 1983 Seabright Trust 11,300
Administration Co. 1984 Ballard 10,000
Administration Co. 1984 Seabright Corp. 25,840
TMT 1985 Mary Ballard 160,000
Administration Co. 1988 Seabright Corp. 5,000

Kanter entities made the following "loans" to Lisle, his family members, and entities established for the benefit of Lisle's family members:

Lisle Loans

Lender	Year	Distributee	Amount
Int'l Films 1974	RWL Cinema Trust		$15,000
Int'l Films 1975	RWL Cinema Trust II		20,000
Int'l Films 1975	Lisle		10,000
Int'l Films 1976	RWL Cinema Trust		5,000
Int'l Films 1976	RWL Cinema Trust II		18,000
Int'l Films 1977	RWL Cinema Trust II		5,000
Int'l Films 1978	Lisle		9,500
Int'l Films 1978	RWL Cinema Trust II		3,750
Int'l Films 1978	RWL Cinema Trust II		4,469
Int'l Films 1979	Lisle		8,784

Int'l Films 1979 RWL Cinema Trust II 3,000
Int'l Films 1980 RWL Cinema Trust II 250
Int'l Films 1981 RWL Cinema Trust II 2,750
Int'l Films 1982 RWL Cinema Trust II 2,320
Int'l Films 1983 RWL Cinema Trust II 3,000
HELO 1983 Basking Ridge Trust 95,000
IRA/Int'l Films 1983 Lisle 3,000
Int'l Films 1984 RWL Cinema Trust II 3,000
Administration Co. 1985 RWL Cinema Trust II 3,000
Int'l Films 1986 RWL Cinema Trust II 3,000
Administration Co. 1987 RWL Cinema Trust II 2,463
IRA 1988 RWL Cinema Trust II 6,000
BWK 1989 RWL Cinema Trust II 3,000
BWK 1990 RWL Cinema Trust II 2,969

Generally, borrowed funds are not included in a taxpayer's gross income "because the taxpayer's obligation to repay the funds offsets any increase in the taxpayer's assets". United States v. Centennial Sav. Bank FSB, 499 U.S. 573, 582, 111 S.Ct. 1512, 113 L.Ed.2d 608 (1991); accord Moore v. United States, 412 F.2d 974, 978 (5th Cir.1969); United States v. Rochelle, 384 F.2d 748, 751 (5th Cir.1967). The hallmarks of a loan are: (1) Consensual recognition between the borrower and the lender of the existence of the loan, i.e., the obligation to repay; and (2) bona fide intent on the part of the borrower to repay the funds advanced. See Collins v. Commissioner, 3 F.3d 625, 631 (2d Cir.1993), affg. T.C. Memo.1992-478.
There was no loan agreement between the various Kanter entities and Ballard or Lisle. There was never any attempt to collect on the receivables until after the IRS began questioning the bona fides of the loans. By that time the loans had already been written off as worthless. Even then Ballard and Lisle denied that they had any obligation to repay. There is no doubt that the distribution payments to Ballard and Lisle were not loans.
Similarly, there is no doubt that the payments made by KWJ Corp. and the KWJ partnership to Ballard and Lisle's adult

children were not for services rendered by the children. From 1982, KWJ Corp. and the KWJ Co. partnership paid the Lisle and Ballard children the following amounts as consulting fees:

	Lisle Children		Ballard Children	
Year	Thomas Lisle	Amy Albrecht	Melinda Ballard	Karen Hart
1982	$7,000	$7,000	$7,000	--
1983	12,000	12,000	12,000	--
1984	12,000	12,000	12,000	$2,000
1985	12,000	11,000	12,000	12,000
1986	12,000	13,000	12,000	12,000
1987	12,000	12,000	12,000	12,000
1988	12,000	12,000	12,000	12,000

During 1989, KWJ Co. paid the Lisle and the Ballard children $36,000. Of the $36,000 paid to the children in 1989, Lisle's children received at least $18,000 and Ballard's children received at least $12,000.

Petitioners claim that Thomas Lisle and Melinda Ballard were paid the consulting fees for various services they provided to KWJ Corp. or KWJ Co. (KWJ). During the timeframe that Thomas Lisle was receiving $1,000 a month, he was employed elsewhere full time. During part of this time, Thomas Lisle was employed with the Vantage Company (Eulich's company).

Melinda Ballard received $1,000 a month from KWJ from 1983 through parts of 1989. She did not know the nature of KWJ's business. Neither Thomas Lisle nor Melinda Ballard ever met or spoke to Freeman.

Karen Ballard Hart (Hart) also received $1,000 a month. During the time that Hart was receiving $1,000 a month from KWJ, she was employed elsewhere.

Hart testified that the "service" she performed was to attend

Urban Land Institute and Hotel Industry meetings. After she attended these meetings, she would sometimes tell Kanter what she had heard at the meetings, and sometimes she would not tell him what she had heard. Half of the time, Kanter was at the same meetings she attended. Hart described her role as "more of a general hotel industry trend thing" that she would tell Kanter about whenever she was asked. She did not know that she supposedly worked for KWJ. The $1,000 a month that Hart received was paid to her by checks from Administration Co., and she testified that she worked for Administration Co.

Amy Albrecht (Albrecht) described her role as looking at "deals". Albrecht's testimony that she submitted on the average anywhere from 20 to 40 deals a year to Freeman greatly exceeds the 5 or 6 deals a year she had previously claimed during an interview with IRS agents. The $1,000 a month that Albrecht received did not depend on what she did or how many "deals" she looked at. She received $1,000 a month even if she did nothing. The checks issued to Albrecht were from either KWJ or Administration Co. During the time that Albrecht was receiving $1,000 a month from KWJ or Administration Co., she was employed by the Vantage company.

The testimony of Thomas Lisle, Melinda Ballard, Hart, and Albrecht is not credible. They performed no services for KWJ. The payments to them were from funds Ballard and Lisle earned from the Prudential transactions.

The record clearly shows that Kanter, Ballard, and Lisle agreed to share the payments made by the Five related to the Prudential transactions that were paid to IRA, Zeus, and KWJ Corp. in the ratio of 45 percent each to Ballard and Lisle and 10 percent to Kanter. Most of the funds were accumulated in IRA or a subsidiary until after Ballard and Lisle left Prudential. It was then that 45 percent of the accumulated funds were distributed to each of Lisle and Ballard, respectively, through Carlco and TMT, and 10 percent to Kanter through BWK, Inc.

Respondent has established by clear and convincing evidence that Ballard failed to report income from the Five in the following amounts for each of the years at issue:

Year	Omitted Income
1978	$17,277
1979	186,758
1980	391,538
1981	467,972
1982	710,001
1984	337,715
1987	300,900
1988	283,440
1989	358,492

Respondent has established by clear and convincing evidence that Lisle failed to report income from the Five in the following amounts for each of the years at issue:

Year	Omitted Income
1984	337,715
1987	300,900
1988	283,440
1989	358,492

Respondent has established by clear and convincing evidence that Kanter omitted income from the Five in the following amounts for each year at issue:

Year	Prudential	Other	Omitted Income
1978	$3,839	--	$3,839
1979	41,502	--	41,502
1980	87,009	--	87,009
1981	103,994	$80,616	184,610

1982	157,778	70,538	228,316
1983	72,181	294,075	366,256
1984	75,048	822,840	897,888
1986	63,353	1,069,335	1,132,688
1987	66,867	132,322	199,189
1988	62,987	96,188	159,175
1989	79,665	42,332	121,997

For each of the years 1979 through 1989, Kanter filed Federal income tax returns which reported adjusted gross income and income tax paid as follows:

Year	Adjusted Gross Income (Loss)	Tax Paid
1978	($44,386)	$1,671
1979	(105,084)	--
1980	(155,026)	--
1981	(53,614)	--
1982	(287,536)	--
1983	(819,449)	--
1984	(804,482)	--
1985	(954,695)	--
1986	(1,529,213)	--
1987	(2,004,257)	--
1988	(1,340,459)	--
1989	(1,331,576)	--

Kanter paid no Federal income taxes during an 11-year period, and only minimum tax in 1978 of $1,671. However, he did pay self-employment tax for the years 1978 ($1,434), 1979 ($1,855), 1980 ($2,098), and 1983 ($3,338).
Because respondent has shown by clear and convincing evidence that Kanter, Ballard, and Lisle omitted income on their Federal income tax returns for each of the years at issue, respondent has clearly proven the underpayments of income tax attributable to such omitted income for those

years.

E. Intent to Evade Tax

Next, respondent must show by clear and convincing evidence that Ballard, Lisle, and Kanter intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes. See Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir.1968).

The existence of fraud is a question of fact to be resolved upon consideration of the entire record. See Gajewski v. Commissioner, 67 T.C. 181, 199, 1976 WL 3591 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir.1978). Fraud is not presumed or imputed; it must be established by independent evidence that establishes a fraudulent intent on the taxpayer's part. See Otsuki v. Commissioner, 53 T.C. 96, 106, 1969 WL 1605 (1969). Because direct proof of a taxpayer's intent is rarely available, fraud may be proved by circumstantial evidence, and reasonable inferences may be drawn from the relevant facts. See Spies v. United States, 317 U.S. 492, 499, 63 S.Ct. 364, 87 L.Ed. 418 (1943); Stephenson v. Commissioner, 79 T.C. 995, 1006, 1982 WL 11202 (1982), affd. 748 F.2d 331 (6th Cir.1984). For example, an intent to conceal or mislead may be inferred from a pattern of conduct, see Spies v. United States, supra at 499, or from a taxpayer's entire course of conduct, see Stone v. Commissioner, 56 T.C. 213, 223-224, 1971 WL 2605 (1971). Likewise, a pattern showing a consistent underreporting of income, when accompanied by circumstances evidencing an intent to conceal, may justify a strong inference of fraud. See Parks v. Commissioner, 94 T.C. 654, 664, 1990 WL 48997, (1990). Additions to tax for fraud have been upheld where taxpayers received income from illegal kickback schemes. See Tregre v. Commissioner, T.C. Memo.1996-243, affd. without published opinion 129 F.3d 609 (5th Cir.1997); DeVaughn v. Commissioner, T.C. Memo.1983-712; Hanhauser v. Commissioner, T.C.1978-504. These cases bear some factual similarities to the instant cases.

Factors Indicative of Fraudulent Intent

Courts have relied on a number of indicia of fraud in deciding fraud cases. The existence of several indicia is persuasive circumstantial evidence of fraud. See Solomon v. Commissioner, 732 F.2d 1459, 1461 (6th Cir.1984), affg. per curiam T.C. Memo.1982-603. A non-exclusive list of circumstantial evidence which gives rise to a finding of fraudulent intent includes: (1) a pattern of understating income over an extended period of time; see Foster v. Commissioner, 391 F.2d 727, 733 (4th Cir.1968), affg. in part, revg. in part T.C. Memo.1965-246); (2) implausible or inconsistent explanations of behavior; see Bahoric v. Commissioner, 363 F.2d 151, 153 (9th Cir.1966); Factor v. Commissioner, 281 F.2d 100 (9th Cir.1960), affg. T.C. Memo.1958-94; (3) failure to cooperate with tax authorities; see McCullough v. Commissioner, T.C. Memo.1993-70; (4) failure to produce records during discovery, see Scallen v. Commissioner, 877 F.2d 1364, 1370 (8th Cir.1989), affg. T.C. Memo.1987-412; (5) destruction of records, see Estate of Beck v. Commissioner, 56 T.C. 297, 1971 WL 2514 (1971); (6) misleading statements or actions, see McManus v. Commissioner, T.C. Memo.1972-200, affd. without published opinion 486 F.2d 1399 (4th Cir.1973), (7) commingling of personal assets with those of the taxpayer's corporation in an attempt to avoid tax, see United States v. Walton, 909 F.2d 915 (6th Cir.1990); (8) diversion of income to third parties, see Lewis v. Commissioner, T.C. Memo.1983-547; (9) reporting income from property beneficially owned by the taxpayer on the returns of family members, see Lang v. Commissioner, T.C. Memo.1961-134; (10) structuring of a business and use of cash management techniques which made difficult the tracing of income, see Scallen v. Commissioner, supra at 1370- 1371; (11) banking devices used to conceal earnings, see Maddas v. Commissioner, 114 F.2d 548 (3d Cir.1940), affg. 40 B.T.A. 572 (1939); (12) concealing income under the names of other persons who reported such income, see Hecht v. Commissioner, 16 T.C. 981, 1951 WL 146 (1951); and (13) omission of income from

the taxpayer's property, title to which was held in names of others who reported the income therefrom, see Furnish v. Commissioner, 262 F.2d 727 (9th Cir.1958). In addition, the taxpayer's educational background and experience are relevant. See Scallen v. Commissioner, supra at 1371; United States v. Stein, 437 F.2d 775 (7th Cir.1971).

1. Lisle's Fraud

Respondent has proven by clear and convincing evidence that Lisle underpaid his taxes for each of the years at issue attributable to omitted income from transactions related to the Five.

Respondent has also proven by clear and convincing evidence that Lisle intended to evade taxes known to be owing on that income by conduct designed to conceal, mislead, or otherwise prevent the collection of such taxes. The record contains several indicia of Lisle's fraud with intent to evade tax.

In determining the presence or absence of fraud, we consider the training and experience of the taxpayer. See Iley v. Commissioner, 19 T.C. 631, 635, 1952 WL 110 (1952). Lisle graduated from the University of Missouri with a B.S. degree in public administration. He attended law school at the University of Missouri, graduate schools of management and business at Columbia University, and the graduate school of management at Princeton University. Lisle was an experienced and sophisticated businessman who held high executive positions at Prudential and later at Travelers. As such, he obviously understood and fully appreciated his obligation to report income correctly and to pay taxes on that income. Nevertheless, he disregarded this obligation by participating in various schemes to collect kickbacks from the Five and misdirect income through Kanter's maze of entities.

Consistent and substantial understatements of income are strong evidence of fraud. See Marcus v. Commissioner, 70 T.C. 562, 577, 1978 WL 3338 (1978), affd. without published

opinion 621 F.2d 439 (5th Cir.1980). Moreover, a pattern of consistent underreporting of income, when accompanied by other circumstances indicating an intent to conceal income justifies the inference of fraud. See Holland v. United States, 348 U.S. 121, 137, 75 S.Ct. 127, 99 L.Ed. 150 (1954). Lisle omitted income received from transactions with the Five during the years 1984 and 1987 through 1989 in the total amount of $1,280,547. Additionally, for the years 1978 through 1983, 1984, and 1985, years not before us here, he omitted $2,734,707.

Lisle allowed Kanter to commingle his share of the kickback moneys in the laundering mechanism Kanter created to conceal the true nature of the income and the identity of the earner of the income. Lisle's use of the various Kanter sham entities (including among others, IRA, Carlco, KWJ Corp., KWJ Co., Essex, Zeus, Holding Co., Int'l Films, HELO, Administration Co., and Principal Services) made it difficult and sometimes impossible to trace the cash-flow and is substantial evidence of Lisle's intent to evade tax. See Scallen v. Commissioner, supra at 1371. Commingling by laundering is an indication of fraudulent intent. See United States v. Jackson, 983 F.2d 757 (7th Cir.1993). Commingling of the kickbacks in the accounts of the conduit entities, together with other unrelated income, was a device to hide the kickbacks from Prudential and the IRS, and is evidence of fraud. See Maddas v. Commissioner, 114 F.2d 548 (3d Cir.1940).

There is fraud where there is a scheme to "thwart the effective functioning of the IRS" and where there is an attempt to disguise the source of income. See United States v. Browning, 723 F.2d 1544, 1547 (11th Cir.1984). Lisle plainly attempted to disguise the source of the kickback funds by the manner employed in sending the moneys through a roundabout method over a period of many years through Kanter's conduit entities. To be sure, the movement of the moneys had no legitimate business purpose, as demonstrated by the evidence.

The use of nominees, placing money or property in the name

of another, is indicative of fraud. See United States v. Peterson, 338 F.2d 595 (7th Cir.1964); Furnish v. Commissioner, supra, where the Court of Appeals stated that "Concealment by itself is indicative of a willful intent to evade income taxes." Lisle used IRA and later Carlco as a nominee to receive and hold and conceal the kickback payments he received for his services.

Failure to cooperate with revenue agents during an audit examination is indicative of fraud. See Bradford v. Commissioner, 796 F.2d 303 (9th Cir.1986), affg. T.C. Memo.1984-601. As reflected in our findings of fact, Lisle did not cooperate with respondent's agents at various stages of their investigation of his tax returns. He withheld relevant documents and information involving transactions with the Five.

Destruction of records and attempts to place records beyond the reach of the revenue agents are evidence of fraud. See Prokop v. Commissioner, 254 F.2d 544 (7th Cir.1958), affg. T.C. Memo.1957-75; Estate of Beck v. Commissioner, 56 T.C. 297, 1971 WL 2514 (1971). We find that Lisle discarded and permitted others, including Kanter, Gallenberger, and Weisgal, to discard supporting income documentation, which was an intentional act designed to conceal and evade the reporting and payment of Federal income tax.

Misleading statements or actions are evidence of fraud. See McManus v. Commissioner, T.C. Memo.1972-200, affd. without published opinion 486 F.2d 1399 (4th Cir.1973). Lisle made the following misleading statements to the IRS agents who interviewed him during their examination of Kanter's returns:

(1) Lisle told the agents that Schaffel had transacted business with Prudential prior to Kanter's introduction of Schaffel to Lisle;

(2) he told the agents that he was not aware of the dispute between Kanter and Schaffel regarding kickbacks for Travelers' deals;

(3) he told the agents that he was not aware of any

agreement between Schaffel and Kanter to share commissions Schaffel earned from the introduction to Ballard and Lisle.

(4) he told the agents that Kanter mainly dealt with the field offices when introducing people to Prudential for business;

(5) he denied any knowledge of the Christie Trust established for the benefit of his children;

(6) he denied any knowledge of the Christie Trust's ownership of Carlco stock; and

(7) he claimed that he had only recently learned about loans made by the Kanter entities to his family trusts and denied that any loans had been made to him.

Lisle's pattern of consistent and substantial underreporting of income, along with other indicia indicating an intent to conceal income, justifies our finding that Lisle's underpayment of tax attributable to the income he omitted from transactions involving the Five is attributable to fraud.

2. Ballard's Fraud

Respondent has proven by clear and convincing evidence that Ballard underpaid his taxes for each of the years at issue attributable to omitted income from transactions related to the Five. Respondent has also proven by clear and convincing evidence that Ballard intended to evade taxes known to be owing on that income by conduct designed to conceal, mislead, or otherwise prevent the collection of such taxes. There are several indicia of Ballard's fraud with intent to evade tax.

Although Ballard's educational background is not in the record, he was a sophisticated and experienced businessman who held high executive positions at Prudential, and later at Goldman Sachs. As such, he obviously understood and fully appreciated his obligation to report income correctly and to pay taxes on that income. Nevertheless, he disregarded this obligation by participating in various schemes to collect kickbacks from the Five and misdirect income through Kanter's maze of entities.

As our findings show, Ballard omitted income received from transactions with the Five during the years 1978 through 1982, 1984, and 1987 through 1989 in the total amount of $3,054,093. Additionally, for the years 1983, 1985, and 1986, years not before us here, he omitted $961,161.

Ballard used IRA and later TMT as a nominee to receive and hold the kickback payments he received for his services.

Ballard did not cooperate with respondent's agents at various stages of their investigation of his tax returns. He withheld relevant documents and information involving transactions with the Five.

Ballard discarded and permitted others, including Kanter, Gallenberger, and Weisgal, to discard supporting income documentation, an intentional act designed to conceal and evade the reporting and payment of Federal income tax.

Ballard allowed Kanter to commingle his share of the kickback moneys in the laundering mechanism Kanter used to conceal its identity. Ballard's use of the various Kanter sham entities (including among others, IRA, TMT, KWJ Corp., KWJ Co., Essex, Zeus, Holding Co., Int'l Films, HELO, Administration Co., and Principal Services) made it difficult and sometimes impossible to trace the cash-flow and is substantial evidence of Ballard's intent to evade tax.

Commingling the kickbacks in the accounts of the conduit entities, together with other unrelated income, was a device to hide the kickbacks from Prudential and the IRS, and is evidence of Ballard's fraud.

Ballard plainly attempted to disguise the source of the kickback funds by funneling money in the roundabout method through the conduit entities over a period of many years.

Ballard made the following misleading and false statements:

(1) He testified that at the dinner meeting where Kanter introduced Schaffel to Ballard and Lisle, they only discussed politics, football, and religion, and that no business was discussed;

(2) he testified that he did not know whether Walters had transacted any business with Prudential when Ballard was at

Prudential and that he was not involved with the Ramada Renaissance property; yet he met with Schaffel and Walters to finalize the financing of the Cherry Creek Place II and the Ramada Renaissance properties;

(3) he testified that Prudential did not purchase the Schnitzer-PMS stock because, apart from the potential conflict of interest, Prudential did not have any business to give to Schnitzer-PMS; yet Prudential started giving Schnitzer- PMS substantial business;

(4) he testified that he had no involvement and no meetings with Connolly other than seeing him at the Gateway hotel; yet he is the person who introduced Connolly to Eulich for purposes of setting up the Essex arrangement.

Finally, we find Ballard's testimony vague, evasive, and unreliable as to the kickback payments in the face of overwhelming evidence to the contrary.

Ballard's pattern of consistent and substantial underreporting of income, when accompanied by the other indicia indicating an intent to conceal income, justifies our finding that Ballard's underpayment of tax attributable to income he omitted from transactions involving the Five is attributable to fraud.

3. Kanter's Fraud

Kanter was the architect who planned and executed the elaborate scheme with respect to the kickback income payments received from the transactions involving the Five. Ballard and Lisle participated with him, shared in the payments, and cooperated in the diversions. In our view, what we have here, purely and simply, is a concerted effort by an experienced tax lawyer and two corporate executives to defeat and evade the payment of taxes and to cover up their illegal acts so that the corporations, Prudential and Travelers, and the Federal Government would be unable to discover them.

Respondent has proven by clear and convincing evidence that Kanter underpaid his taxes for each of the years at issue attributable to transactions related to the Five. Respondent

has also proven by clear and convincing evidence that Kanter intended to evade taxes known to be owing on that income by conduct designed to conceal, mislead, or otherwise prevent the collection of such taxes.

The record is replete with several indicia of Kanter's fraud. They are:

First, Kanter has a legal education. He has been a practicing tax attorney since 1956. He has taught courses in estate and gift taxation and estate planning at the University of Chicago Law School. He has lectured and written extensively in the area of Federal tax law. For a number of years, he has been a writer and contributor to the Journal of Taxation, a national monthly publication devoted exclusively to Federal taxation. Kanter, as an experienced tax attorney, obviously understood and fully appreciated his legal obligations to report income correctly and to pay taxes on that income. Nevertheless, he disregarded these obligations by conceiving and carrying out various schemes to misdirect income. Furthermore, he was or should have been aware that his Federal income tax liabilities were substantially underreported for each of the years in issue.

Second, as we have previously found, Kanter reported adjusted gross losses on his Federal income tax returns for every year from 1978 through 1989. For 11 of those years he paid no Federal income taxes, and only minimum tax of $1,671 in 1978. Kanter omitted income received from transactions with the Five during the years 1978 through 1989 (except for 1985) in the total amount of $3,422,469. Even for 1985, a year not before us here, he omitted $1,592,939.

Third, Kanter created a complex laundering mechanism made up of sham corporations and entities (including among others, IRA, Carlco, TMT, BWK, Inc., KWJ Corp., KWJ Co., Essex, Zeus, Holding Co., Int'l Films, HELO, Administration Co., and Principal Services) to receive, distribute, and conceal his income, as well as Ballard's and Lisle's income. Payments made for their services were paid to IRA and Holding Co. or one of their subsidiaries. The

payments were commingled with funds from other entities in Administration Co.'s accounts and later Principal Service's accounts. Large amounts of money were distributed to various entities and individuals, including Kanter, Ballard, and Lisle, through IRA, Holding Co., HELO, Int'l Films, and the Bea Ritch trusts. The distributions were disguised as loans and recorded as receivables. The receivables were shuffled (through book entries) between the various entities and eventually written off. Kanter's use of the various sham entities made it difficult and sometimes impossible to trace the flow of the money and is substantial evidence of his intent to evade tax. See Scallen v. Commissioner, 877 F.2d 1364, 1370-1271 (8th Cir.1989).

Fourth, as reflected in our findings of fact, Kanter did not cooperate with respondent's agents at various stages of their investigation of his tax returns. He withheld relevant documents and information involving transactions with the Five and the movement of moneys through the conduit entities such as Administration Co., IRA, Holding Co., and others.

Kanter caused some records to be destroyed and attempted to place other records beyond the reach of the revenue agents conducting the investigation. We find in particular that destruction of records that were the subject of the IRS summonses after the issuance of the summonses to be a strong indication of fraud. "The summons had no time limit, was never withdrawn, and * * * required the recipient to retain--indefinitely--the documents within its scope." United States v. Administrative Enters., Inc., 46 F.3d at 673.

Gallenberger and Weisgal claim that records had been discarded pursuant to a 3-year retention policy based on the normal 3-year statute of limitations for assessing tax deficiencies. Yet the records they destroyed related to returns that were being audited and were the subject of IRS administrative summonses. We think that such a 3-year retention policy could not justify the destruction of corporate minutes, stock ownership records, or resolutions by the

boards of directors. Moreover, some of the entities involved were trusts or corporations owned by trusts. Corporate officers and directors, as well as trustees of trusts, are often required to account to shareholders and beneficiaries for periods greater than 3 years. None of the individuals involved with the various entities (Gallenberger, Weisgal, Meyers, and Schott) acted in any independent manner. They all acted as directed by Kanter. It is clear that they destroyed the records at Kanter's direction.

Kanter, a tax professional who represents clients before the IRS and this Court, is aware of the need for documentation and records to support the items reported on tax returns. In light of that knowledge, coupled with other evidence, we find that his discarding of his supporting income documentation was an intentional act designed to conceal and evade the reporting and payment of Federal income tax.

Fifth, Kanter's commingling of his income with the moneys of others is an indication of fraud in an attempt to avoid tax. United States v. Walton, 909 F.2d 915 (6th Cir.1990). The use of IRA and the other entities by Kanter and the commingling of the kickback moneys were part of the laundering mechanism designed by Kanter. All of the commingling of Kanter's income, as well as that of Ballard and Lisle, was done at his direction. Commingling of the kickbacks in Administration Co.'s accounts, together with other unrelated income, was designed to conceal the kickbacks. The commingling and laundering are evidence of fraud. Maddas v. Commissioner, 114 F.2d 548 (3d Cir.1940); United States v. Jackson, supra.

Sixth, Kanter's scheme was intended to "thwart the effective functioning of the IRS" and was an attempt to disguise the source of income. Kanter plainly attempted to disguise the source of the kickback funds by the manner employed in sending the moneys through conduit entities in a roundabout method over a period of many years. Obviously, he, as well as Ballard and Lisle, did not want Prudential and Travelers to know about the kickback payments. Certainly, the movement of the moneys had no legitimate business

purpose.

Seventh, Kanter's reporting of the kickback moneys on the returns of IRA and Holding Co. was designed to conceal the scheme, and is another strong indication of Kanter's fraud. See Lang v. Commissioner, T.C. Memo.1961-134, where the reporting of income from property beneficially owned by the taxpayer on the returns of family members was held to be fraudulent. It is clear that Kanter used the sham corporations to give the appearance that the kickback income was earned by them, rather than Ballard, Lisle, and himself, and that there was no tax due by the corporations because there were claimed losses sufficient to offset the income. Moneys were distributed from IRA and Holding Co. at Kanter's direction to other entities that were created to conceal further the true nature of the payments. Three of those entities, TMT, Carlco, and BWK Inc., were controlled respectively by Ballard, Lisle, and Kanter, and were the repositories of the kickback moneys distributed from IRA.

Eighth, Kanter routinely used the various conduit entities as nominees, placing money and property in the names of the entities to conceal the transactions. In fact, when it was convenient, he would assert that the entity held an asset merely as nominee.

Ninth, Kanter created phony loans to disguise the distributions of the income to himself and others and to evade the income tax due on the income. He later arranged for sales of the receivables for nominal amounts in order to claim false bad debt deduction losses and offset additional income reported on his returns and the returns of the conduit entities.

Tenth, as discussed previously, Kanter's testimony at trial was implausible, unreliable, and sometimes contradictory. We did not find it credible.

Finally, other factors that support a finding of Kanter's fraud include, but are not limited to, manipulations of deductions and income between various corporate, partnership, and trust entities to conceal not only his income but the income

the use of the various artifices to divert the payments to his children and trusts benefiting his family.

Kanter's substantial understatements of income over an 11-year period, his intentional misdirection of income, and his deliberate mischaracterizations of the transactions are clear and convincing evidence of his fraudulent intent to evade taxes, particularly in light of his legal education and experience and overall tax sophistication. See Scallen v. Commissioner, 877 F.2d 1364, 1370-1371 (8th Cir.1989); Sisson v. Commissioner, T.C. Memo.1994-545, affd. without published opinion 108 F.3d 339 (9th Cir.1996); Wheadon v. Commissioner, T.C. Memo.1992-633.

The transactions involved here were masquerades, concealing the true character of the payments. In reality, an attorney and two highly successful businessmen conspired to conceal millions of dollars of kickbacks, using a multitude of entities with friends and employees serving as officers of

Ballard and Lisle and evade taxes properly owed to the Government.

As each layer of Kanter's complex organization is removed, and the flow of the money is followed, the magnitude of the fraud is revealed. Kanter's explanations are mere platitudes and rationalized rhetoric intended to obfuscate the true character of the transactions and his wrongdoing.

f. Summary and Conclusions as to Fraud

The addition to tax or penalty in the case of fraud is a civil sanction provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud. Helvering v. Mitchell, 303 U.S. 391, 401, 58 S.Ct. 630, 82 L.Ed. 917 (1938). The facts, as we have found in detail, clearly show that Kanter, Ballard, and Lisle, through the use of various conduit entities, devised a multifaceted scheme to shield kickback payments they received from transactions involving the Five. Their fraud

resulted in the Federal Government not being paid several millions in income taxes due and owing. Clearly, the Government incurred great expense investigating petitioners' returns. The investigation took years and involved the efforts of dozens of IRS agents and several Government attorneys.

Petitioners created profitable business deals between the Five and Prudential and Travelers. The large sums of money they received as kickbacks were diverted at Kanter's direction to their controlled conduit entities. To effectuate the part of the scheme involving the Prudential transactions, Kanter through his related entities (IRA and its subsidiaries), retained the moneys for a period of time until they were distributed directly or indirectly to Ballard, Lisle, and himself in a 45-45-10 percent split. To effectuate the remaining part of the scheme involving the payments for Kanter's services, including payments from the Schaffel/Travelers transactions, Kanter caused the moneys to be paid to Holding Co., which he controlled.

As a result of the overall scheme, over $13 million of kickback and other income was omitted by petitioners collectively. The evidence is clear and convincing that they intended to evade the payment of their taxes on such omitted income. Accordingly, after considering all the facts and circumstances contained in the massive record of these cases, we hold that Kanter, Ballard, and Lisle are liable for the fraud additions to tax and penalties for each of the years at issue.

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Footnotes

FN1. Cases of the following petitioners are consolidated herewith: Burton W. and Naomi R. Kanter, docket No. 712-86; Investment Research Associates, Ltd., and Subsidiaries, docket No. 45273-86; Burton W. and Naomi R. Kanter, docket No. 1350-87; Burton W. and Naomi R. Kanter, docket No. 31301-87; Burton W. and Naomi R. Kanter, docket No. 33557- 87; Burton W. and Naomi R. Kanter, docket No. 3456-88; Investment Research Associates, Ltd., and Subsidiaries, docket No. 30830-88; Burton W. and Naomi R. Kanter, docket No. 32103-88; Investment Research Associates, Ltd., and Subsidiaries, docket No. 27444-89; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 16421-90; Investment Research Associates, Ltd., and Subsidiaries, docket No. 25875-90; Burton W. and Naomi R. Kanter, docket No. 26251-90; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 20211-91; Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, docket No. 20219-91; Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co- executors, docket No. 21555-91; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 21616-91; Investment Research Associates, Ltd., and Subsidiaries, docket No. 23178-91; Burton W. and Naomi R. Kanter, docket No. 24002-91; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 1984-92; Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co- executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, docket No. 16164-92; Investment Research Associates, Ltd., and Subsidiaries, docket No. 19314-92; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 23743-92; Burton W. and Naomi R. Kanter, docket No. 26918-92; Estate of Robert W. Lisle, Deceased, Thomas W.

Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co- executors, docket No. 7557-93; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 22884-93; Investment Research Associates, Ltd., and Subsidiaries, docket No. 25976-93; and Burton W. and Naomi R. Kanter, docket No. 25981-93.

FN2. Unless otherwise indicated, section references are to the Internal Revenue Code in effect for the years at issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

FN3. With respect to the additions to tax under sec. 6653, as to all of the cases before the Court, for the years 1979 and 1980, the addition to tax is under sec. 6653(a). For the years 1981 through 1985, the addition to tax is under sec. 6653(a)(1). For the years 1981 through 1985, respondent also determined the addition to tax under sec. 6653(a)(2), which is 50 percent of the interest due on the underpayment of tax attributable to negligence or intentional disregard of rules or regulations. For the years 1986 and 1987, the addition to tax is under sec. 6653(a)(1)(A), and the determined 50-percent interest due on the underpayment is under sec. 6653(a)(1)(B). For 1988, the addition to tax is under sec. 6653(a)(1), and there is no corresponding addition to tax for 50 percent of the interest due on the underpayment. See Technical and Miscellaneous Revenue Act of 1988, Pub.L. 100-647, sec. 1015(b)(2)(A), 102 Stat. 3342, 3568, applicable to returns the due date for which, without regard to extensions, is after Dec. 31, 1988.

FN4. Sec. 6621(d)(1) was added by the Deficit Reduction Act of 1984, Pub.L. 98-369, sec. 144(a), 98 Stat. 682, and provides for interest of 120 percent of the adjusted interest rate due on any substantial underpayment of tax attributable to tax-motivated transactions. The increased interest is effective for interest accruing after Dec. 31, 1984. Sec. 6621(d) was

redesignated as sec. 6621(c) by sec. 1511(c)(1)(A) of the Tax Reform Act of 1986, Pub.L. 99-514, 100 Stat.2085, 2744, and repealed by sec. 7721(b) of the Omnibus Budget Reconciliation Act of 1989 (OBRA 89), Pub.L. 101-239, 103 Stat. 2106, 2399, effective for tax returns due after Dec. 31, 1989, OBRA 89 sec. 7721(d), 103 Stat. 2400.

FN5. For the years 1976 through 1981, the addition to tax for fraud is under sec. 6653(b). For the years 1982 through 1985, the addition to tax for fraud is under sec. 6653(b)(1) and (2). For 1986 and 1987, the addition to tax for fraud is under sec. 6653(b)(1)(A) and (B). For 1988, the addition for fraud is under sec. 6653(b)(1). For 1989, the penalty for fraud is under sec. 6663(a).

FN6. In some of the cases, if petitioners are sustained on the fraud issue, respondent will be barred by the statute of limitations from assessment as to those petitioners.

FN7. Prudential conducted its real estate equity and joint venture operations in the name of PIC Realty in those States that prohibited insurance corporations from directly engaging in real estate development.

FN8. The Everglades Trusts 1-5, shareholders in Holding Co., were grantor trusts in which Kanter was the deemed owner under secs. 671 through 678.

FN9. Administration Co. was organized at the insistence of some of the members of Kanter's law firm who complained that law firm employees working under Kanter were performing extensive nonlegal services for which the law firm was not being compensated.

FN10. Gallenberger was an accountant. Shortly after arriving in Chicago, Illinois, she passed the certified public accountant's examination. Gallenberger became an employee of Administration Co. in 1982.

FN11. The record does not contain the information for 1982.

FN12. Prior to 1979, Schaffel had rented office space from Torcivia.

FN13. The $1.3 million purchase price was roughly based on a multiple of five times net earnings. At the time, the company had before-tax net income of $250,000.

FN14. After Lisle began working for Travelers in 1982, he dealt with Eulich in connection with the managing of Travelers' properties.

FN15. Although Hilton Hotels had been reluctant to grant Prudential a franchise, Ostroff obtained the franchise by pointing out to Hilton Hotels the other profitable business dealings it had with Prudential.

FN16. Prudential did not want to have its employees involved in operating the hotel and did not want any of the hotel's employees to be Prudential employees.

FN17. The letter stated:
Per our telephone conversation today, I am enclosing the following material: 1. Your 20 shares of stock in Gateway Hotel Management Company representing 20% of the company.
2. A xerox copy of 80 shares of stock owned by Essex Hotel Management Company representing 80% of the company.
3. A copy of the minutes of the first meeting of the Board of Gateway--the original is being circulated for signature and will be sent for signature soon.
4. A xerox copy of your option on the Essex Hotel Management Company stock--the original is being circulated for signature currently.
As we discussed on the phone, we will be sending you a check for $10,000.00 which represents the capitalization of Gateway that should be used as the corporation's initial bank

deposit. When the first profit distribution is made we would appreciate your sending us a check for $2,000 representing 20% of this capital.
If you have any questions about this transaction, please let me know. We are looking forward to working with you in what is hopefully a mutually pleasant and profitable venture.

FN18. On Dec. 21, 1984, Essex Corp. assigned its option to purchase the 80 shares of Gateway Corp. to the Essex partnership.

FN19. Although Ostroff and Prudential ultimately awarded the Midland, Texas, hotel's management contract to Gateway Corp., Gateway Corp. and Eulich-Management had each submitted bids on the Midland hotel's management contract. During this time, Prudential usually obtained bids from at least three hotel management companies for a particular hotel's management contract.

FN20. The Eulich-Management agreement indicates that, although it was effective as of Jan. 1, 1982, it was executed as of July 5, 1982.

FN21. The consulting and participation agreement for the Twin Sixties hotel was entered into to replace the income that Essex would lose following the expected termination of Eulich-Management's management contract for the Allentown Hilton, as the Allentown Hilton was then in the process of being sold.

FN22. Essex reported its income on the cash method until 1987. For the 1987 taxable year and thereafter Essex reported on the accrual method.

FN23. During the years at issue the consolidated net losses did not equal the total of the net losses of the consolidated group because of special deductions.

FN24. IRA's 1978 return reported $1,442,930 total assets as of the close of the year, $34,024 of which was the amount of its investment in subsidiaries. The 1979 return reported $1,592,930 of total assets as of the beginning of the year, $184,024 of which was the amount of its investment in subsidiaries. The $150,000 difference is the amount IRA agreed to pay for the KWJ Corp. stock.

FN25. On IRA's 1988 consolidated return, IRA reported that it contributed $60,000 to Decisions Holding Corp. in the sec. 351 transaction in exchange for 85 percent of the stock of Decisions Holding Corp. The return, however, also reported the transfers of IRA's stock in Cedilla Invest. and Zeus to Decisions Holding Corp. See infra Issue 23.

FN26. On December 5, 1983, Zeus transferred $13,000 to IRA in exchange for a $13,000 receivable from Holding Co. IRA's general ledger shows that in 1983 Holding Co.'s subsidiary Zion acquired from IRA a $15,000 receivable due from Holding Co. for $15,000. The 1984 general ledger shows that Zeus' loans receivable of $866,000 included $802,000 owed by Holding Co. and $64,000 owed by HELO. The record does not disclose how Zeus acquired the remaining receivable of $15,000 from Holding Co.

FN27. Based on IRA's consolidated returns, Zeus contributed to unidentified partnerships $100,000 in 1979 and $127,372 in 1980 and received a return of capital of $63,696 in 1981 and $1 in 1982 (probably due to rounding of numbers) computed as follows:

1979 Initial contribution $100,000
Plus 1980 nontaxable income 6,828

Total adjustments and contributions 106,828

Plus 1980 contributions

value end 1980 234,200
less prior adjustments and contributions (106,828)

1980 contributions 127,372 127,372

Value end 1980 234,200

Value end 1980 234,200
plus 1980 taxable income 2,382
---
total adjustments and contributions 236,582

Less return of capital
value end 1981 172,896
less prior adjustments and contributions (236,582)

1981 return of capital (63,686) (63,686)

Value end 1981 172,896

Value end 1981 172,896
Less 1982 taxable loss (150,907)
Less 1982 nontaxable loss (27,061)
---
total adjustment and contributions (5,072)

Less return of capital
value end 1982 (5,073)
less prior adjustments and contributions 5,072

1982 return of capital (1) (1)

Value end 1982 (5,073)

Value end 1982 (5,073)
Less 1983 taxable loss (15,049)
Less 1983 nontaxable loss (753)

Value end 1983 (20,875)

FN28. Schaffel also paid $312,750 to IRA in 1983 for fees related to Traveler's transactions.

FN29. The difference between total of $44,412 and $44,413 is due to rounding of numbers.

FN30. Thomas Lisle and Amy Albrecht admitted that they received consulting fees from 1983 to 1989. Melinda Ballard admitted that she received the consulting fees from 1983 to 1988. Karen Hart admitted that she received the consulting fees from 1984 to 1989. No one except the Lisle and Ballard children received consulting fees from 1983 through 1989. We conclude that the payments made in 1982 were also made to Thomas Lisle, Amy Albrecht, and Melinda Ballard.

FN31. Approximately $4,000 per month was paid to the Ballard and Lisle children. IRA made distributions to KWJ Corp. and KWJ partnership that were also approximately $4,000 a month. The money distributed to KWJ Corp. and KWJ partnership was never repaid during the years in question, and no interest was ever paid on the amounts outstanding.

FN32. The record is unclear whether all four each received $9,000, or whether Thomas Lisle, Amy Albrecht, and Karen Hart each received $12,000. Melinda Ballard testified that she resigned from KWJ Co. in 1988. If that was the case, then of the $36,000 paid by KWJ Co. in 1989, Thomas Lisle, Amy Albrecht, and Karen Hart each received $12,000. If Melinda Ballard did not resign, then each of the four children received $9,000 during 1989. Thomas Lisle and Amy Albrecht together received at least $18,000 during 1989, and Ballard's children received at least $12,000.

FN33. The Morkan Trust is named after Kanter's father,

Morris Kanter.

FN34. No treasurer was listed for 1985.

FN35. No treasurer was listed from 1985 through 1990, and no vice president was listed from 1983 through 1987 and in 1990.

FN36. In 1979, the CMB Cinema Trust was divided into 10 separate trusts.

FN37. In 1983, HELO was a subsidiary of Holding Co. On Aug. 31, 1984, Kanter as trustee of the ARO Trusts became the owner of 100 percent of HELO's voting stock.

FN38. It is not clear from the record whether HELO made the distributions to the Basking Ridge and Summit trusts during 1983 or at some earlier time.

FN39. IRA had transferred the interest in the 1984 Development partnership as part of the 1983 writeoff. The value of the interest for that transfer was $86,400.

FN40. MAF was a wholly owned subsidiary of Computer Placement Services, Inc. (Computer Placement Services).

FN41. By Sept. 1, 1985, HELO was no longer a subsidiary of Holding Co.

FN42. During the bankruptcy proceeding for Administration Co., the only documents that bankruptcy counsel for Administration Co. may have received from Administration Co. were copies of its tax returns. He received none of the books and records of the clients of Administration Co. The documents sought by the summons which was the subject of the summons enforcement proceeding did not ask for the tax returns of Administration Co. The summons sought the books and records relating to transactions involving the

Kanters for the years 1983, 1985, 1986, 1987 and 1988. These records were not given to the bankruptcy counsel. They were given to Kanter.

FN43. The Court of Appeals stated: "It is apparent that the Government is interested in transactions in which Kanter and his family and their investment vehicles are involved and not just in the terms of the custodianship arrangement." United States v. Administrative Enters., Inc., 46 F.3d 670, 673 (7th Cir.1995).

FN44. Walter Ross was senior vice president of finance of Century Development Corp. at the time of Schnitzer's purchase of Fletcher Emerson. Ross testified that it was customary in the industry to base the purchase price of a service corporation such as Fletcher Emerson on the pretax income of the company.

FN45. Under the stock agreement entered into by Century and IRA when IRA purchase the Schnitzer-PMS stock, upon the death of the last to die of Kanter, Weisgal, and Schott, Century had the option to purchase IRA's stock. The purchase price for IRA's stock under the agreement was an amount in excess of 8 times Schnitzer-PMS's average pretax income. Eight times Schnitzer-PMS pretax income for 1977 is over $3.6 million.

FN46. Roland Burrows, chief office and president of Schnitzer-PMS during the years at issue, testified that the business of the corporation grew at about 25 percent each year until about 1976. The rate of growth slowed substantially after that time because of the size of the corporation.

FN47. Under the stock agreement entered into by Century and IRA when IRA purchased the Schnitzer-PMS stock, the purchase price for IRA's stock was an amount in excess of 8 times Schnitzer-PMS's average pretax income. Eight times

Schnitzer-PMS pretax income from 1976 to 1978 ($533,500) is more than $4.2 million. Based on that value all of the stock in the corporation was worth more than $8 million.

FN48. The Court, however, is not convinced that Cedilla Co. was organized for any purpose other than to serve as a vehicle for Kanter's various tax avoidance schemes.

FN49. Keating's preferred stock was redeemed in 1977.

FN50. Sec. 1.482-1A(b)(1), Income Tax Regs provides:
The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable incomes are thereby understated, the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Nos. 01-17249-GG, 01-17251-GG ,01-172 3-GG
01-17255-GG, 01-17256-GG, 01-17257 GG .

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

CLAUDE M. BALLARD and MARY B. BALLARD,
Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellees.

Appeals from a Decision of the United States Tax Court

ON PETITION(S) FOR REHEARING AND PETITION(S)
FOR REHEARING EN BANC
(Opinion 11th Cir., 19 , F.2d).

Before; HULL, FAY and GIBSON*, Circuit Judges.

PER CURIAM:

The Petition(s) for Rehearing are DENIED and no Judge in regular active service on the Court having requested that, the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure), the Petition(s) for Rehearing En Banc are DENIED.

ENTERED FOR THE COURT:
UNITED STATES CIRCUIT JUDGE

Footnotes

*Honorable John R. Gibson, United States Circuit judge for the Eight Circuit, sitting by designation.

Docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93 and 25981-93

UNITED STATES TAX COURT

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECLARATION OF RANDALL G. DICK

Randall G. Dick, for his Declaration under penalty of perjury, pursuant to 28 U.S.C. 1746, states as follows:

1. I am of full age, and if called to testify, would be competent to give the testimony as to the following matters.

2. I am counsel for Investment Re arch Associates, Ltd. and Subsidiaries and for Burton and Naomi Kanter.

3. In its Opinion in this matter filed on December 15, 1999 (T.C. Memo 1999-407) the U.S. Tax Court concluded, with respect to issue 1, that payments made by Hyatt, Frey, Schaffel, Schnitzer and Eulich (the "Five") were taxable to the individual Petitioners and the individual Petitioners were liable for the fraud additions to tax and penalty with respect to such income. (Opinion, 226-319).

4. Subsequent to the issuance of the Tax Court's

Opinion, Declarant was informed by two judges of the Tax Court, that in his original report submitted to the Chief Judge pursuant to Rule 183(b), Special Trial Judge D. Irwin Couvillion concluded that payments made by the Five were not taxable to the individual Petitioners and that the fraud penalty was not applicable.

5. In my conversations with the judges of the Tax Court, I was told the following: That substantial sections of the opinion were not written by Judge Couvillion, and that those sections containing findings related to the credibility of witnesses and findings related to fraud were wholly contrary to the findings made by Judge Couvillion in his report. The changes to judge Couvillion's findings relating to credibility and fraud were made by Judge Dawson.

6. Judge Dawson`s revisions resulted in a finding that over nine million dollars is taxable to the individual Petitioners. This finding based upon credibility of witnesses, results in liability of the individual Petitioners for tax, penalties and interest in an amount in excess of $30,000,000.

7. I confirmed the information, in paragraphs 4 and 5 above with another judge of this Court, who informed me that in fact, the Opinion was changed, and that to his knowledge, it was the first time the Tax Court had made an outright rejection of credibility findings made by a Special Trial judge.

8. I was also told by a judge of the Tax Court that the changed sections of the report were written in such a way so that wherever there was the "slightest issue of doubt, it went against" the Petitioners.

I declare under penalty of perjury that the foregoing is true and correct and that this Declaration is executed in San Francisco, California on August 21, 2000.

RANDALL G. DICK

Docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93 and 25981-93

UNITED STATES TAX COURT

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ORDER

For cause, it is

ORDERED: That these cases are reassigned from Special Trial Judge D. Irvin Couvillion to Judge Howard A. Dawson, Jr., for disposition.

After the Special Trial Judge submitted a report, as required by Rule 183(b), Tax Court Rules of Practice and Procedure, these cases were referred to Judge Dawson on September 2, 1998, for review and, if approved, for adoption.

Mary Ann Cohen
Chief Judge

Dated; Washington, D.C.
December 15, 1999

Docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93 and 25981-93

UNITED STATES TAX COURT

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ORDER

On August 22, 2000, petitioners filed a motion for Reconsideration of the Court's Denial of Petitioners' Motion for Access to Original Special Trial Judge Report Prepared Under Rule 183(b) or, In The Alternative, for a New Trial. This is the third time petitioners have filed a motion seeking access to "all reports, draft opinions, or similar documents prepared and delivered to the Court pursuant to Rule 183(b)". By Order dated April 26, 2000, the Court denied petitioners' motion in all respects setting forth its reasons. In that Order it was stated that the provisions of section 7443A(b) (4), Internal Revenue Code, and Rule 183, Tax Court Rules of Practice and Procedure, were followed by the Court. See Freytag v. s ion , 501 U.S. 868, 871-875 (1991), affg. 904 F.2d 1011, 1014-1015 (5th Cir. 1990). Section 7443A(b) (4) provides that the chief judge may assign to special trial judges "any other proceeding which the chief judge may designate, to be heard by the special trial judges of the court". Rule 183, first adopted effective January 16,

1984, provides as follows:

(a) Trial and Briefs: A Special Trial Judge shall conduct the trial of any such case assigned for such purpose. After such trial, the parties shall submit their briefs in accordance with the provisions of Rule 151. Unless otherwise direct, no further briefs shall be filed.

(b) Special Trial Judge's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the Special Trial Judge shall submit a report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a Judge or Division of the Court.

(c) Action on the Report: The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

The Note to Rule 183 states:

"The prior provisions for service of the Special Trial Judge's report on each party and for the filing of exceptions to that report have been deleted". 81 T.C. at 1070. The reason for the Note was that procedures which existed before January 16, 1984, were changed by Rule 183.

The present procedures of Rule 183 were expressly approved by the Supreme Court in Freytag v. Commissioner, 501 U.S. at 874, where it is stated that special trial judges have the

authority to hear cases and prepare proposed findings and opinions, but that they lack the authority to decide cases under section 7443A(b) (4) because that is "reserved exclusively for judges of the Tax Court".

Also in the Court's order dated April 26, 2000, we stated:

Therefore, petitioners' motion requesting access to any internal Court documents, including any preliminary drafts of reports or opinions, documents, memorandums or notes by judges, special trial judges or employees of the Court, will be denied. In any event such materials are confidential and not subject to production because they relate to the internal deliberative processes of the Court.

On May 30, 2000, the Court denied petitioners' motion to place the original report of the Special Trial Judge under seal and made a part of the record so that it would be available to a court of appeals for review.

In the present motion seeking again access to "all reports, draft opinions or similar documents" prepared pursuant to Rule 183(b), Randall G. Dick, counsel for petitioners Investment Research Associates, Ltd., and Burton W. Kanter and Naomi R. Kanter, for the first time in the motion and in his declaration attached thereto, has made general assertions, without specificity, that two on three judges of the Court informed him that an original report of Special Trial Judge Couvillion "concluded that payments made by the Five were not taxable to the individual Petitioners and that the fraud penalty was not applicable". Although Mr. Dick states in his declaration that some judges commented about the procedures involved in handling these cases, whatever may have been said to Mr. Dick is irrelevant and immaterial.

The only official Memorandum Findings of Fact and

Opinion by the Court in these cases is T.C. Memo. 1999-407, filed on December 15, 1999, by Special Trial Judge Couvillion, reviewed and adopted by Judge Dawson, and reviewed and approved by former Chief Judge Cohen.

Judge Dawson states and Special Trial Judge Couvillion agrees, that, after a meticulous and time-consuming review of the complex record in these cases, Judge Dawson adopted the findings of fact and opinion of Special Trial Judge Couvillion, that Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and that Judge Dawson gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses.

Petitioners have requested that Judge Dawson recuse himself from further consideration of these cases. He declines to do so. Chief Judge Wells upon review of the motion and consideration of the matter concludes that there are no valid grounds for compelling Judge Dawson to recuse himself.

In the alternative, petitioners have moved that the Court order a new trial before a new Tax Court judge. Chief Judge wells views this as a motion without sufficient grounds to support it. Therefore, a new trial before another judge of the Court will not be ordered. Once the decisions are entered, petitioners may appeal the decisions if they so choose. Accordingly, it is

ORDERED that Petitioners' Motion for Reconsideration of the Court's Denial of Petitioners' Motion for access to original Special Trial Judge Report Prepared Under Rule 183(b) or, In The Alternative, For a New Trial is denied.

Thomas B. Wells
Chief Judge

Howard A. Dawson, Jr.
Judge

D. Irvin Couvillion
Special Trial Judge

Dated: Washington, D.C.
August 30, 2000

Supreme Court, U.S.
FILED
OCT 6 2003
OFFICE OF THE CLERK

(2)

No. 03-184

In the Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

THEODORE B. OLSON
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27 pp

QUESTIONS PRESENTED

When a case is assigned to a Special Trial Judge of the Tax Court, the Special Trial Judge is to make a "report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will [then] assign the case to a Judge or Division of the Court." Tax Ct. R. 183(b). The Judge to whom the case is thus assigned "may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part * * * ." Tax Ct. R. 183(c). The questions presented in this case are:

1. Whether the Due Process Clause requires that the "original" report of the Special Trial Judge be disclosed to the parties.

2. Whether 26 U.S.C. 7482(a), which authorizes appellate review of Tax Court decisions, requires that the "original" report of the Special Trial Judge be disclosed to the parties.

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In the Supreme Court of the United States

No. 03-184

CLAUDE M. BALLARD AND MARY B. BALLARD,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-18a) is reported at 321 F.3d 1037. The opinion of the Tax Court (Pet. App. 19a-306a) is unofficially reported at 78 T.C.M. (CCH) 951.

JURISDICTION

The judgment of the court of appeals was entered on February 13, 2003. The petition for rehearing was denied on May 5, 2003. Pet. App. 307a. The petition for a writ of certiorari was filed on August 4, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Claude Ballard was a senior vice-president of Prudential Life Insurance Co. of America. Acting with another vice-president of that company named Robert Lisle and a tax attorney named Burton Kanter, petitioner participated in a scheme in which persons seeking to do business with Prudential paid kickbacks for such business to Kanter. Kanter then funneled more than $3 million of that money to petitioner through a complex web of corporations, partnerships and trusts. Pet. App. 2a-4a. Petitioner received these kickback payments through a number of devices —such as deposits by Kanter into a corporation controlled by petitioner, sham loans by Kanter to petitioner, and sham consultant payments to members of petitioner's family. *Id.* at 4a.

Petitioner failed to report the kickbacks he received as income on his federal income tax returns. After discovering the kickbacks, the Commissioner issued notices of deficiency to petitioner, Kanter and Lisle for the resulting income tax deficiencies and civil fraud penalties. Pet. App. 5a.

2. Petitioner, Kanter and Lisle each sought review of the Commissioner's determinations in the Tax Court. Pet. App. 19a.

After their cases were consolidated in the Tax Court, the Chief Judge assigned them to be heard by Special Trial Judge D. Irvin Couvillion pursuant to 26 U.S.C. 7443A(b)(4). After a lengthy trial, the Special Trial Judge submitted a report on these consolidated cases to the Chief Judge as required by Tax Court Rule 183(b). The cases were then referred by the Chief Judge to Tax Court Judge Howard A. Dawson for decision. Pet. App. 5a-6a, 311a. On December 15, 1999, the Tax Court

issued an opinion in the consolidated cases which states that "[t]he Court agrees with and adopts the opinion of the Special Trial Judge, which is set forth below." *Id.* at 33a. This opinion of the Tax Court sustained the major portion of the deficiencies and penalties determined by the Commissioner.

3. Petitioner, along with Kanter and Lisle, thereafter filed a motion seeking access to "all reports, draft opinions or similar documents, prepared and delivered to the Court pursuant to Rule 183(b)." Pet. App. 6a. In the alternative, they asked the Tax Court to make a copy of such materials a part of the record in the case. *Ibid.*; App., *infra*, 1a. The Tax Court denied this motion, stating that (*id.* at 2a):

> In reviewing the Special Trial Judge's report, Judge Dawson gave due regard to the fact that Special Trial Judge Couvillion evaluated the credibility of witnesses, as reflected in the Memorandum Findings of Fact and Opinion (T.C. Memo. 1999-407), and he treated the findings of fact recommended by the Special Trial Judge as being presumptively correct. * * * [T]he provisions of section 7443A(b)(4) and Rule 183 were followed by the Court.

The Tax Court emphasized that "Petitioners appear not to appreciate the distinction between the special trial judges' authority to hear cases and prepare proposed findings and opinions under [26 U.S.C. 7443A(b)(4)] and their lack of authority actually to decide those cases, which is reserved exclusively for judges of the Tax Court." App., *infra*, 3a (quoting *Freytag* v. *Commissioner*, 501 U.S. 868, 874 (1991)). The Tax Court concluded that, "[i]n any event such materials are confidential and not subject to production because they relate to

the internal deliberative processes of the Court. Cf. Sec. 7460(b)." App., *infra*, 3a.

Petitioner then filed a second motion requesting that the Special Trial Judge's report be included in the record under seal. That motion was also denied by the Tax Court. Pet. App. 6a.

4. Petitioner then moved for reconsideration or for a new trial. Pet. App. 6a-7a. Attached to this motion was an affidavit of Randall G. Dick, counsel for Kanter. In that affidavit. Dick stated that he had been informed by two or three unnamed judges of the Tax Court that Special Trial Judge Couvillion had recommended in his "original" report that the kickback "payments made by 'the [persons seeking to do business with Prudential] were not taxable to the individual petitioners and that the fraud penalty was not applicable." *Id.* at 7a, 309a.

The Tax Court denied that motion in an order signed by Chief Judge Thomas B. Wells, Judge Dawson, and Special Trial Judge Couvillion. The court stated that "[t]he only official Memorandum Findings of Fact and Opinion by the Court in these cases is T.C. Memo. 1999-407, filed on December 15, 1999, by Special Trial Judge Couvillion, reviewed and adopted by Judge Dawson, and reviewed and approved by former Chief Judge Cohen." Pet. App. 314a-315a. The Tax Court stated that the alleged statements purportedly made to Dick were thus "irrelevant and immaterial." *Id.* at 314a. The court further stated that (*id.* at 315a):

> Judge Dawson states and Special Trial Judge Couvillion agrees, that, after a meticulous and time-consuming review of the complex record in these cases, Judge Dawson adopted the findings of fact and opinion of Special Trial Judge Couvillion, that Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and that Judge Dawson gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses.

5. Petitioner, along with Kanter and Lisle, then filed petitions for mandamus in the Eleventh, Seventh, and Fifth Circuits, respectively, in which they sought orders directing Judge Dawson and the Tax Court to provide them with a copy of the "original" report prepared by Special Trial Judge Couvillion. In the alternative, they sought an order directing the Tax Court to describe any changes made to the initial report submitted by Special Trial Judge Couvillion. The petitions for writs of mandamus were denied. *In re Ballard*, No. 00-14762-H (11th Cir. Oct. 23, 2000); *In re Investment Research Associations & Sub. and Burton W. and Naomi R. Kanter*, No. 00-3369 (7th Cir. Dec. 15, 2000); *In re Estate of Robert W. Lisle*, No. 00-60637 (5th Cir. Sept. 18, 2000).

6. After the entry of final decisions, petitioner appealed to the Eleventh Circuit, Kanter appealed to the Seventh Circuit, and Lisle appealed to the Fifth Circuit. All three of these courts of appeals rejected the assertion that the proceedings in the Tax Court denied the taxpayers the due process of law. Pet. App. 1a-18a; *Kanter* v. *Commissioner*, 337 F.3d 833 (7th Cir. 2003); *Lisle* v. *Commissioner*, 341 F.3d 364 (5th Cir. 2003).

In the present case, the court of appeals emphasized that the fact that the order of the Tax Court was signed by the Special Trial Judge, as well as by the reviewing judge and the chief judge, demonstrates "that the report adopted by the Tax Court accurately reflected [the Special Trial Judge's] findings and opinion." Pet. App. 10a. Responding to the affidavit of the taxpayer's

counsel, who asserted that the opinion underwent changes prior to its final adoption by the Tax Court, the court stated that (*id.* at 9a-10a):

> Even assuming [this] affidavit to be true and affording Petitioners-Appellants all reasonable inferences, the process utilized in this case does not give rise to a due process concern. While the procedures used in the Tax Court may be unique to that court, there is nothing unusual about judges conferring with one another about cases assigned to them. These conferences are an essential part of the judicial process when, by statute, more than one judge is charged with the responsibility of deciding the case. And, as a result of such conferences, judges sometimes change their original position or thoughts. Whether Special Trial Judge Couvillion prepared drafts of his report or subsequently changed his opinion entirely is without import insofar as our analysis of the alleged due process violation pertaining to the application of Rule 183 is concerned. Despite the invitation, this court will simply not interfere with another court's deliberative process.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Petitioner asserts that his right to due process was violated when he has not given a copy of the "original" report of the special trial judge. Petitioner claims that he has a due process right to examine the "original" report (Pet. i, 7-27) because a special trial judge assigned to hear a case is the "fact-finder" (Pet. 3, 7-9, 11, 20, 22, 24) whose findings are to be reviewed under a "clearly erroneous" standard (Pet. 7, 9, 14, 17-20). Petitioner further contends that the special trial judge proposed findings that he owed no deficiencies and that the Tax Court disagreed with those proposed findings and persuaded the special trial judge to change his mind through assertedly impermissible "ex parte" communications with the Special Trial Judge (Pet. 7, 14, 20-23). Finally, petitioner asserts (Pet. 9, 23-24) that it is necessary to include the "original" report of the Special Trial Judge in the record so that the court of appeals may review the decision of the Tax Court "in the same manner and to the same extent as decisions of the district courts" (26 U.S.C. 7482(a)). Each of these contentions lack merit.

a. Sections 7443A(b)(1)-(3) and (c) of the Internal Revenue Code permit the chief judge to assign particular types of cases—which are ordinarily small cases—to be heard and decided by special trial judges. 26 U.S.C. 7433A(b)(1)-(3), (c). At the time relevant to this case, Section 7443A(b)(4) of the Code (now subsection (b)(5)) authorized the chief judge to assign "any other proceeding" to special trial judges for hearing and recommended decision only. 26 U.S.C. 7443A(b)(5). Any decision in this latter category of cases must be entered by a regular Tax Court judge. The present case, involving the concealed kickback income received by petitioner, was assigned to the special trial judge only for hearing and recommended decision under this statute. App., *infra*, 1a.

The Internal Revenue Code does not prescribe procedures to be employed by the Tax Court in its use of special trial judges. Instead, Congress has authorized the Tax Court to adopt rules prescribing such procedures. 26 U.S.C. 7443A(a), 7453. Rule 183 of the Tax

Court was adopted pursuant to this authority. That Rule neither authorizes nor requires disclosure to the parties of the reports and recommendations prepared by special trial judges. Instead, in light of the requirement that cases that are assigned only for hearing by a special trial judge must ultimately be decided by a regular judge of the Tax Court (26 U.S.C. 7443A(c)), Rule 183 notes that the reports prepared by the special trial judge merely "recommend" findings and that the judge to whom the chief judge assigns the case "may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions." Tax Ct. R. 183(c).

A judge of the Tax Court to whom a case is ultimately assigned may thus either (i) adopt or abandon the special trial judge's report in its entirety or (ii) modify or otherwise use the special trial judge's report as a step in the fact-finding process. Under Tax Court Rule 183, as well as under the deliberative processes of courts generally, communications between the judges (and special trial judges) to whom a case is assigned for disposition are not produced or disclosed to the parties. Pet. App. 2a-3a. See *Goetz* v. *Crosson*, 41 F.3d 800, 805 (2d Cir. 1994), cert. denied, 516 U.S. 821 (1995); *United States* v. *Crouch*, 566 F.2d 1311, 1316 (5th Cir. 1978); *In re Cook*, 49 F.3d 263, 265 (7th Cir. 1995); *Fayerweather* v. *Ritch*, 195 U.S. 276, 306-07 (1904). As the court of appeals emphasized in this case, "there is nothing unusual about judges conferring with one another about cases assigned to them." Pet. App. 9a.

b. It has, moreover, long been settled that, in cases in which due process requires a trial-type hearing, findings may be made by an officer who has "heard" the

evidence in the sense of having reviewed and considered the evidence. Due process does not mandate that the officer charged with making the findings and decision also have personally observed the testimony in the case. In *Morgan* v. *United States*, 298 U.S. 468 (1936), this Court explained that, while "[t]he one who decides must hear," this does not require personal observation of the witnesses (*id.* at 481-482) (emphasis added):

> Evidence may be taken by an examiner. Evidence thus taken may be sifted and analyzed by competent subordinates. Argument may be oral or written. The requirements are not technical. But there must be a hearing in a substantial sense. And *to give the substance of a hearing*, which is for the purpose of making determinations upon evidence, *the officer who makes the determinations must consider and appraise the evidence which justifies them.*

In *Morgan*, the examiner who personally heard the testimony declined to prepare a tentative report that could then be subjected to argument and exceptions before the Secretary to whom the authority to enter the decision had been given by Congress. *Id.* at 475-476. In rejecting the contention that such a procedure was required, this Court stated that, "while it would have been good practice to have the examiner prepare a report and submit it to the Secretary and the parties, and to permit exceptions and arguments addressed to the points thus presented * * * we cannot say that that particular type of procedure was essential to the validity of the hearing * * *." *Id.* at 478. Similarly, in *Utica Mutual Insurance Co.* v. *Vincent*, 375 F.2d 129, 131 (2d Cir.), cert. denied, 389 U.S. 839 (1967), the court rejected the contention that, "when there are issues of

credibility * * * no determination of fact may be made unless the decider has either seen the witnesses himself or has been furnished with a report as to credibility by another." The court stated that "[e]ven on issues where due process requires a 'trial type' hearing, the due process clause makes no such inexorable command." See *NLRB* v. *Mackey Radio & Tele. Co.*, 304 U.S. 333, 350-351 (1938).

In the analogous circumstance in which a case that has been tried by one judge of the Tax Court is then reviewed by the full Tax Court, Congress has made clear since the very origins of that court that the "original" opinion of the judge who presided at trial is to be excluded from the record.[1] Revenue Act of 1928, ch. 852, § 601, 45 Stat. 791 (codified at 26 U.S.C. 7460(b)). And, the courts of appeals have consistently rejected the contention that these procedures contravene due process. *Estate of Varian* v. *Commissioner*, 396 F.2d 753 (9th Cir.), cert. denied, 393 U.S. 962 (1968); *Heim* v. *Commissioner*, 251 F.2d 44 (8th Cir. 1958). See *Towers* v. *Commissioner*, 247 F.2d 233 (2d Cir. 1957), cert. deneid, 355 U.S. 914 (1958); *Halle* v. *Commissioner*, 175 F.2d 500, 504 (2d Cir. 1949), cert. denied, 338 U.S. 949 (1950); *Seaside Improvement Co.* v. *Commissioner*, 105 F.2d 990, 992 (2d Cir.), cert. denied, 308 U.S. 618 (1939).

c. Contrary to petitioner's contention, a regular judge of the Tax Court is not to limit his review of recommended findings of a special trial judge through

[1] There is no merit to petitioner's assertion (Pet. 16, 18 n.15) that *Universal Camera* v. *NLRB*, 340 U.S. 474 (1951), supports his contention that an "original" report of a special trial judge must be included in the record. In *Universal Camera*, it was the governing statute that required that an examiner's report be included in the record. *Id.* at 493. In the present case, neither 26 U.S.C. 7443A nor Rule 183 contains such a requirement.

application of a "clearly erroneous" or other deferential standard of review. The requirement of Rule 183 that "due regard" be given to the proposed findings of the special trial judge does not effectively transfer the authority to make decisions in such cases from the regular trial judges to the special trial judges. Congress has not granted authority to the chief judge of the Tax Court to allow special trial judges to decide cases that must be assigned to regular judges for decision. Regular judges are therefore not to defer to, or apply a "clearly erroneous" standard in reviewing, the proposed findings of special trial judges in such cases. See, *e.g.*, *Colorado* v. *New Mexico*, 467 U.S. 310, 317 (1984) (in reviewing exceptions to findings of a special master, the special master's findings "deserve respect and a tacit presumption of correctness" but "the ultimate responsibility for deciding what are correct findings of fact remains with us"); *Kanter* v. *Commissioner*, 337 F.3d at 843-844.[2]

[2] Prior to the adoption of the Tax Court's current rules, one court of appeals had held that the recommended findings of special trial judges of the Tax Court should be reviewed by a judge of the Tax Court under a clearly erroneous standard. *Stone* v. *Commissioner*, 865 F.2d 342 (D.C. Cir. 1989), rev'g *Rosenbaum* v. *Commissioner*, 45 T.C.M. (CCH) 825 (1983). As the Fifth Circuit pointed out in *Freytag* v. Commisisoner, 904 F.2d 1011 (1990), aff'd, 501 U.S. 868 (1991), however, *Stone* was decided under the prior rules of the Tax Court that provided that litigants were to be furnished with copies of special trial judges' proposed findings and conclusions and then given an opportunity to take exception thereto, with only the exceptions to be reviewed by a regular judge of the Tax Court. 904 F.2d at 1015 n.8. By eliminating those procedures, the Tax Court Rules now make it clear that review by a regular judge of a special trial judge's report is not an appellate review but is an exercise of the regular trial judge's original fact-finding authority. *Ibid.*

2. Petitioner also errs in asserting that Tax Court Rule 183 violates his rights to due process because it departs from "traditional practice" and common law (Pet. 12-13). At common law, tax controversies were resolved in a branch of the "court of exchequer" and were not "judicial controversies * * * according to the ordinary course of the common law or equity." *Murray's Lessee* v. *Hoboken Land and Improvement Co.*, 59 U.S. (18 How.) 272, 282 (1855). The Exchequer was analogous to an administrative agency. 9 W. Holdsworth, *A History of English Law* 239 (7th ed. 1926)); A. Carter, *A History of the English Courts* 51 (1944). Unlike litigation that must be assigned to an Article III court for adjudication, tax cases may be resolved in Article I legislative courts, for they are "public rights" cases which "Congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper." *Crowell* v. *Benson*, 285 U.S. 22, 51 (1932), *quoting Murray's Lessee*, 59 U.S. (18 How.) at 284; see *Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 68, 70 n.22 (1982); *Ex parte Bakelite Corp.*, 279 U.S. 438, 451 (1929). There is thus no "traditional practice" or "common law" requirement that Tax Court judges operate in a manner precisely identical to Article III courts. Instead, "the Chief Judge [may] assign *any* Tax Court proceeding, regardless of complexity or amount, to a special trial judge for hearing and the preparation of proposed findings and written opinion." *Freytag* v. *Commissioner*, 501 U.S. at 877.

3. Petitioner claims, in the alternative (Pet. 24-25), that an "original" report of a special trial judge must be provided to the parties and included in the record in order for a court of appeals properly to review a decision of the Tax Court. Under 26 U.S.C. 7482(a), the

courts of appeals are to review "decisions" of the Tax Court "in the same manner and to the same extent" as decisions of the district courts in civil actions tried without a jury. The report of a special trial judge, however, is plainly *not* the "decision" of the Tax Court. 26 U.S.C. 7459; Tax Ct. R. 183(b). It is the decision of the Tax Court, not the recommendation of the special trial judge, that is the subject of the appellate jurisdiction of the courts of appeals.

Moreover, as the court of appeals emphasized in this case, "[t]he record reveals, and we accept as true, that the underlying report adopted by the Tax Court *is* Special Trial Judge Couvillion's." Pet. App. 10a (emphasis added). The Tax Court made that same factual determination in rejecting the identical arguments raised by petitioner in the proceedings below. App., *infra*, 2a; see pages 4-5, *supra*. These factual determinations, "concurred in by two lower courts" (*Rogers* v. *Lodge*, 458 U.S. 613, 623 (1982)), do not warrant review by this Court. *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).[3]

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[3] Petitioner's insistent claim that the opinion agreed to and adopted by the Tax Court was not the opinion of the special trial judge is refuted by the record. Even assuming that the special trial judge had a view of petitioner's case at the time he submitted his "original" report that differed from the views that are reflected in the opinion ultimately entered in the case, it does not follow that the opinion adopted by the Tax Court was not, in fact, the opinion of the special trial judge. To the contrary, the opinion of the Tax Court (Pet. App. 33a) and an order signed by Special Trial Judge Couvillion himself (*id.* at 7a) make clear that the opinion of the court *does* accurately set forth the opinion reached by Special Trial Judge Couvillion. It is, of course, possible that Judge Couvillion may have revised his views of the case during the deliberative process, but "there is nothing unusual about judges conferring with one another about cases assigned to them * * * [a]nd, as a result

4. Petitioner asserts that the Tax Court routinely makes changes to the "original" reports prepared by special trial judges without telling the parties. Petitioner claims (Pet. 9-10) that this is evidenced by the absence of any indication in 765 cases decided since 1984 (when the Tax Court rules were changed to their current form) that the "original" report had been amended before its adoption by the Tax Court. During the period from 1976 through 1984, however, when parties were provided copies of reports of special trial judges and afforded an opportunity to file exceptions thereto (see note 2, *supra*), there were only six cases (out of approximately 680 decisions) in which the Tax Court did not adopt the opinion of the special trial judge. And, in only one of those opinions did the reviewing judge of the Tax Court disagree with or "reverse" the special trial judge. See *Kansas City So. Ry.* v. *Commissioner*, 76 T.C. 1067 (1981); *Narver* v. *Commissioner*, 75 T.C. 53 (1980); *Hilton* v. *Commissioner*, 74 T.C. 305 (1980); *La Fargue* v. *Commissioner*, 73 T.C. 40 (1979); *Richard* v. *Commissioner*, 69 T.C. 750 (1978); *C. Blake McDowell, Inc.* v. *Commissioner*, 67 T.C. 1043 (1977).[4] There is thus no factual basis for petitioner's unsupported assertion that when (as in the present case) the Tax Court issues an opinion that adopts the report of a special trial judge, it fails accu-

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of such conferences, judges sometimes change their original position or thoughts." *Id.* at 9a.

[4] In several other cases (14 out of approximately 680 cases involving special trial judges that were decided between 1976 and 1984), the Tax Court adopted the opinion of the special trial judge with modifications that were, in most instances, described as "minor." See *Ocean Sands Holding Corp.* v. *Commissioner*, 41 T.C.M. (CCH) 1, 2 (1980).

rately to set forth the view of the special trial judge in the case.

Nor do the communications that occur among judges with a collaborative responsibility represent prohibited ex parte communications. As the Tax Court emphasized in this case, internal communications among judges and special trial judges are part of the internal deliberative process of the court. App., *infra*, 3a. As the court of appeals correctly observed, "there is nothing unusual about judges conferring with one another about cases assigned to them * * * [a]nd, as a result of such conferences, judges sometimes change their original position or thoughts" (Pet. App. 9-10a). See *Checkosky* v. *SEC*, 23 F.3d 452, 489-490 (D.C. Cir. 1994) ("[i]n agencies as in courts, votes are not final until decisions are final; and decisions do not become final until they are released, accompanied by an explanation of the reasons for the result"; "the exchange of draft opinions can and does change votes"). This form of collaborative judicial process, whether in the Tax Court or in other courts in which a shared decisional process occurs, does not violate due process.

5. The only appellate decisions that have addressed the questions presented in this case are fully in accord with the decision of the Eleventh Circuit in this case. The Seventh Circuit in *Kanter*, *supra*, and the Fifth Circuit in *Lisle*, *supra*, both rejected the assertion that the special trial judge procedures of Rule 183 violate the due process rights of taxpayers. In *Kanter*, the court concluded that Tax Court Rule 183(b) does not require disclosure of a special trial judge's "original" report and does not create a two-tier, appellate type relationship between a special trial judge and regular judge of the Tax Court. 337 F.3d at 843-844, 879-884. The court further held that the Rule does not require a

regular judge to review recommendations of a special trial judge under a clearly erroneous standard and does not prohibit collaboration between a special trial judge and regular judge. *Id.* at 840-844, 877- 879.

In concluding that due process does not require that a copy of the special trial judge's "original" report be provided to taxpayers, the Seventh Circuit in *Kanter* noted and agreed with the reasoning adopted by the Eleventh Circuit in this case. 337 F.3d at 843-844, 878-879. The Fifth Circuit reached the same conclusion in *Lisle*, 341 F.3d at 384. There is thus no conflict among the circuits nor other reason to warrant certiorari in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 2003

APPENDIX

UNITED STATES TAX COURT
Washington, D.C. 20217

Docket Nos. 43966-85,712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984,92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93, 25981-93

INVESTMENT RESEARCH ASSOCIATES LTD., AND SUBSIDIARIES, ET AL, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ORDER

On April 20, 2000, petitioners filed a document entitled Motion for Access to Original Special Trial Judge Report Prepared Under Rule 183(b) and a supporting Memorandum of Points of Authorities. The motion seeks access to "all reports, draft opinions or similar documents prepared and delivered to the Court pursuant to Rule 183(b)". If the motion is denied, petitioners request that the Court certify the issue for an interlocutory appeal pursuant to Rule 193, Tax Court Rules of Practice and Procedure. In the alternative, petitioners have requested that "a copy of the requested materials be made part of the record herein for review by the Circuit Court of Appeals".

These consolidated cases were assigned by the Chief Judge to be heard by Special Trial Judge Couvillion pursuant to section 7443A(b)(4), Internal Revenue Code, and Rule 183(a). They were heard in Chicago, Illinois. After a lengthy trial, consisting of testimonial and voluminous documentary evidence, and the filing of briefs (totaling 4,768 pages with respect to 41 litigated issues), Special Trial Judge Couvillion submitted his report containing findings of fact and opinion pursuant to Rule 183(b), which ultimately became the Memorandum Findings of Fact and Opinion (T.C. Memo. 1999-407) filed on December 15, 1999.

In accordance with Rule 183(c), the Chief Judge referred the cases to Judge Dawson for review and, if approved, for adoption. In reviewing the Special Trial Judge's report, Judge Dawson gave due regard to the fact that Special Trial Judge Couvillion evaluated the credibility of witnesses, as reflected in the Memorandum Findings of Fact and Opinion (T.C. Memo. 1999-407), and he treated the findings of fact recommended by the Special Tr. Judge as being presumptively correct.

The report of the Special Trial Judge, as adopted by Judge Dawson, was then submitted to and reviewed and approved by the Chief Judge, who directed that it be filed as the Court's Memorandum Findings of Fact and Opinion. Thus the provisions of section 7443A(b)(4) and Rule 183 were followed by the Court. See *Freytag v. Commissioner*, 501 U.S. 868, 871-875(1991), affg. 904 F.2d 1011, 1014-1015 (5th Cir. 1990); *Erhard v. Commissioner*, 46 F.3d 1470, 1475-1476 (9th Cir. 1995), which involved identical procedures.

Contrary to petitioners' assertion, the procedures pertaining to United States magistrate judges under 28

U.S.C., Sec. 636(b)(1) in hearing nonjury civil cases are different from those governing special trial judges under section 7443A(b)(4), I.R.C. and Rule 183. In particular, consent of the parties is not required in cases heard by special trial judges; and there is no requirement under Rule 183 that the findings of fact and opinion of a special trial judge be served on the parties and made subject to objections before being assigned to a judge for review and adoption. The Supreme Court expressly stated in *Freytag v. Commissioner*, 501 U.S. at 874:

> Petitioners appear not to appreciate the distinction between the special trial judges' authority to hear cases and prepare proposed findings and opinions under subsection (b)(4) and their lack of authority actually to decide those cases, which is reserved exclusively for judges of the Tax Court.

Therefore, petitioners' motion requesting access to any internal Court documents, including any preliminary drafts of reports or opinions, documents, memorandums or notes by judges, special trial judges or employees of the Court, will be denied. In any event such materials are confidential and not subject to production because they relate to the internal deliberative processes of the Court. Cf. Sec. 7460(b); *Estate of Varian v. Commissioner*, 396 F.2d 753, 754-755, n.2 (9th Cir. 1968), affg. 47 T.C. 34 (1966); *Heim v. Commissioner*, 251 F.2d 44, 48 (8th Cir. 1958), affg. 27 T.C. 270 (1956).

Petitioners next contend that the denial of their motion for production of documents requires the Court to certify the issue for the interlocutory appeal pur-

suant to section 7482(a)(2), I.R.C., and Rule 193, Tax Court Rules of Practice and Procedure.

Section 7482(a)(2) provides in pertinent part:

(a) Jurisdiction.—

(2) Interlocutory orders.—

(A) In general.—When any judge of the Tax Court includes in an interlocutory order a statement that a controlling question of law is involved with respect to which there is a substantial ground for difference of opinion and that an immediate appeal from that order may materially advance the ultimate termination of the litigation, the United States Court of Appeals may, in its discretion, permit an appeal to be taken from such order, if application is made to it within 10 days after the entry of such order.

* * *

In sum, certification of an order pursuant to section 7482(a)(2) is appropriate where the judge verifies that the order: (1) Involves a controlling question of law, (2) with respect to which there is a substantial ground for difference of opinion, and (3) an immediate appeal from that order may materially advance the ultimate termination of the litigation. Failure to meet any one of the three requirements is grounds for denial of certification. See *General Signal Corp. v. Commissioner*, 104 T.C. 248, 251 (1995), citing *Kovens v. Commissioner*, 91 T.C. 74, 77 (1988).

As explained in *Kovens v. Commissioner*, *supra* at 78, the proper application of section 7482(a)(2) requires

a balancing of the policies favoring interlocutory appeals, i.e., avoidance of wasted trial and harm to litigants, against the policies underlying the so-called final judgment rule, i.e., avoidance of piecemeal litigation and dilatory and harassing appeals. In *Kovens*, we observed:

> If the avoidance of wasted trial is taken as the sole guide, a multitude of interlocutory opinions will become appealable. This is contrary to the intent of the draftsmen and proponents of 28 U.S.C. sec. 1292(b) (1958) and section 7482(a)(2), who were of the view that interlocutory orders should be granted only in exceptional cases. See 3 U.S. Code Cong. & Admin. News, at 5255, 5259, 5260-5261 (1958). Such a desire to limit availability of this process to exceptional cases reflects a strong policy in favor of avoiding piecemeal review and its attendant delay and waste of time. * * * [Id.]

Petitioners contend that these cases involve a controlling question of law for which there is a substantial ground for difference of opinion and that an immediate appeal may materially advance the ultimate termination of the litigation. We disagree. We are not persuaded that there are substantial grounds for difference of opinion on the points raised in petitioners' motion. Likewise, the issues presented and decided in *Investment Research Associates, Ltd., and Subsidiaries, et al. v. Commissioner*, T.C. Memo. 1999-407, do not justify certification for immediate appeal. Final decisions in those cases have not yet been entered by this Court. In our view an immediate appeal on the issues raised in petitioners' motion would not materially advance the ultimate termination of the litigation in these cases, but

rather prolong it, thus defeating the purpose of section 7482(a)(2).

Considering all of the circumstances, and balancing the policies underlying section 7482(a)(2) against the final judgment rule, these cases do not represent the type of exceptional cases warranting an interlocutory appeal. Consequently, we will deny petitioners' request for certification for an interlocutory appeal.

Finally, for reasons previously stated, we will deny petitioners' request that copies of any of the requested materials be made a part of the record in these cases for review by the Circuit Court of Appeals. See *Estate of Varian v. Commissioner, supra.*

Accordingly, after due consideration, it is **ORDERED**:

1. That petitioners' Motion for Access to Original Special Trial Judge Report Prepared Under Rule 183(b) is denied in all respects.

2. That petitioners' request to certify this issue for an interlocutory appeal pursuant to section 7482(a)(2), I.R.C., and Rule 193, is denied.

3. That petitioners' request that a copy of the requested materials be made a part of the record in these cases for review by the Circuit Court of Appeals is denied.

/s/ HOWARD A. DAWSON, JR.
HOWARD A. DAWSON, JR.
Judge

Dated: Washington, D.C.
April 26, 2000

(5)

No. 03-184

Supreme Court, U.S.
FILED
OCT 20 2003
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In The

Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

REPLY BRIEF FOR THE PETITIONERS

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REPLY BRIEF FOR THE PETITIONERS

Respondent skirts over the fact that the opinion below endorsed a procedure whereby *one* judge (who is an at-will employee) conducts a trial, views the witnesses, hears the arguments of counsel, makes credibility determinations, and then writes a report with factual findings and legal conclusions, while *other* judges, who are to review the trial judge's work in appellate-style, "confer" with the trial judge off the record in order to change the trial judge's findings, with no public knowledge of *what* the trial judge's original findings were or why they were changed.

The government has never offered a remotely plausible or legitimate rationale for keeping STJs' reports secret. Its sole argument about the meaning of a Tax Court Rule relies on a Circuit split that was created by the decision below and that has further deepened since that decision issued. Due process requires, at a bare minimum, that the fact-finding of the only judge present to observe the witnesses be done *on the record*, so that if any subsequent modification is made, appellate courts can tell whether it was done properly.

The Tax Court's procedure is without precedent or analogue in all of American law. Not only has it affected the many hundreds of taxpayers who have faced trials before Special Trial Judges (STJs) over the past two decades, it will continue to affect thousands who will face such trials in the future. Due to the uncontradicted record evidence here showing that the Tax Court reversed the original STJ report,[1] this case presents a unique opportunity for this Court to address a due process problem that is present, but unlitigated, in many other cases.

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[1] See Affidavit of Randall Dick, Pet. App. at 308a-10a (describing conversation in which two Tax Court judges revealed that the original report in this case was secretly reversed).

A. Respondent Misinterprets Petitioners' Due Process Claims

Let it be clear: Petitioners' case does not hinge on any *per se* objection to the use of Special Trial Judges, or on any objection to the Tax Court's practice of reviewing the reports of STJs. Nor does Petitioners' case stand or fall on any claim that Rule 183 requires clear error review (as opposed to *some* standard of review above *de novo*).

Instead, Petitioners' due process claim is quite simple: When a fact-finder issues a set of findings that are treated as presumptively binding, whether it be a special master's report or a jury's verdict or an STJ's report, those initial fact-findings must be made public. If those initial fact-findings are changed, the change must also occur on the record, so that appellate courts can consider the full record.

Respondent consistently addresses straw-man arguments, rather than coming to grips with Petitioners' claims. Thus, for example, Respondent argues that due process does not require that the final decision be made by someone who "personally observed the testimony in the case." Br. in Opp. 9. Even if correct, this is irrelevant. Petitioners have not claimed that regular judges of the Tax Court are allowed no role in the decision-making process. Rather, the question is whether the Tax Court can leave the parties and the Article III courts in the dark when an otherwise binding credibility determination made by a judge who *was present* has been set aside or modified by his absent employer. *Cf. United States v. Raddatz*, 447 U.S. 667, 681 n.7 (1980); Pet. for Cert. 17-18.

Respondent similarly misses the mark in suggesting that there is "no requirement that Tax Court judges operate in a manner *precisely identical* to Article III courts." Br. in Opp. 12 (emphasis added). Petitioners are not demanding identical behavior. Petitioners are merely asking that the Tax Court observe a fundamental principle of American law: When a fact-finder comes to a presumptively binding conclusion of what the facts are, the parties

have a right to know what that conclusion was, and, if changed, why it was changed.

Respondent repeatedly quotes the Eleventh Circuit's observation that "there is nothing unusual about judges conferring with one another about cases assigned to them."[2] Petitioners do not claim that Tax Court judges and STJs should never be allowed to converse. The point is that if Tax Court judges attempt to persuade the STJ to "revise[] his views of the [facts in the] case," which is the government's own theory of what happened here, Br. in Opp. 13 n.3, the STJ's original report should be made public so that the parties and reviewing courts know what happened.[3]

Finally, Respondent contends that regular judges are "not to defer to, or apply a 'clearly erroneous' standard in reviewing, the proposed findings of special trial judges. . . ." Br. in Opp. 11. This contention is contrary to the Tax Court's own rules, as Petitioners demonstrate in Section B. But even if Rule 183 did not require "clear error" review, it is inconceivable that *no deference* would be due to STJs' decisions. In this case, just as in hundreds of others, the STJ alone conducted the lengthy trial, viewed the dozens

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[2] Br. in Opp. 6, 8, 13 n.3, 15 (quoting *Ballard*, Pet. App. 9a). Respondent provides no citation for this point other than the very decision on review here.

[3] Moreover, while judges *who are peers* (such as the members of this Court or appeals court judges on three-member panels) commonly confer on the outcome of a case, the situation is different where, as here, one judge conducts the trial and makes the *original* findings of fact, while the other judge or judges sit in what amounts to a *reviewing* capacity. See *infra* at 6. Fact-finding is a task uniquely suited to personal observation. While no one doubts the propriety of judges' conferring *generally*, Respondent is unable to cite any case suggesting that anyone – judge or otherwise – who is absent from a trial adds anything but mischief to the *initial* fact-finding process. In no other American court system do *reviewing* judges meet with *trial* judges in order to modify or reverse the outcome with no public record of what the trial judge originally thought. Yet that is exactly what the Tax Court claims the right to do.

of witnesses, and heard the arguments of counsel. By necessity, therefore, the role of regular Tax Court judges is to perform *some sort of review* of the STJ's report. When legitimate questions arise as to whether that review function was performed properly, no one can know what happened if the Tax Court, unlike every other court in the land, insists on keeping the original fact-findings secret.

B. As Respondent's Brief in Opposition Makes Clear, This Case Involves a Persistent and Deepening Conflict Among the Circuits

As Respondent concedes, the decision below that a change in the STJ's original opinion is legitimate when wrought through the Tax Court judge and the STJ "conferring with one another," Pet. App. 9a, turns on the legal conclusion that "[r]egular [Tax Court] judges are . . . not to defer to, or apply a 'clearly erroneous' standard in reviewing, the proposed findings of special trial judges." Br. in Opp. 11. Indeed, that is the only basis upon which Respondent defends the decision below.

The decision of the Eleventh Circuit here flatly conflicts with *Stone v. Commissioner*, 865 F.2d 342 (CADC 1989), in which the D.C. Circuit held that the phrases "due regard" and "presumed to be correct" in Tax Court Rule 183 (then labeled 182) rule required clear error review as to the STJ's findings. On that basis, the D.C. Circuit reversed a Tax Court decision because it had not given the deference required by the Rule to the STJ's report.[4] *Stone* represents the settled rule under which the Tax Court bar has operated since the time it was decided until today. See, *e.g.*, 35 AM. JUR. 2D FED. TAX ENFORCEMENT § 905 (2002) ("The Tax Court is required to review a special trial judge's

[4] The D.C. Circuit continues to adhere to its view of the meaning of Rule 183. See, *e.g.*, *Landry v. Federal Deposit Ins. Corp.*, 204 F.3d 1125, 1133 (CADC 2000).

factual findings according to the clearly erroneous standard, and cannot overturn a special trial judge's ruling on the basis that the Tax Court finds the testimony credited by the trial judge to be unbelievable."); 20A FEDERAL PROCEDURE, L. ED., Internal Revenue § 48:1274 (2000) (same)

1. The decision below squarely conflicts with *Stone* and, as Respondent's Brief in Opposition makes clear, Br. in Opp. 11, the split is deepening. Since the decision below, the Seventh Circuit has explicitly agreed with the court below that the Tax Court Rules do not "prescribe any particular level of deference due the STJ's report," *Kanter v. Commissioner*, 337 F.3d 833, 841 (CA7 2003), and that the Tax Court Judges need not review the STJ's original Reports for "clear error."

Respondent argues that this split is somehow obviated by a 1984 amendment to the Tax Court rules. See Br. in Opp. 11 n.2. But *none* of the language on which the *Stone* Court relied *has ever been changed*.[5] There is therefore no ground to claim that *Stone* has been undermined.

Curiously, Respondent suggests that the very elimination of the publication of the STJ's Report – the only change in the rule wrought by the amendment upon which Respondent would rely – means that *Stone* is no longer good law. "By eliminating [the furnishing to the parties of copies of the STJ's Report], the Tax Court Rules now make it clear that review by a regular judge of a special trial judge's report is not an appellate review. . . . " Br. in Opp. 11 n.2.

[5] The *Stone* court relied *entirely* on the following sentence from the Tax Court's rule: "Due regard shall be given to the circumstance that the commissioner had the opportunity to evaluate the credibility of witnesses; and the findings of fact recommended by the commissioner shall be presumed to be correct." See *Stone*, 865 F.2d at 345-47. This sentence in Rule 183 remains *unchanged to this day*.

Obviously, the change in the Rules does no such thing. The Rule still requires that when STJs conduct trials, other Tax Court judges must, after the fact, give their findings "due regard" and a presumption of correctness. This Court has clearly stated that the use of a "presumption" with respect to a "finding" imposes a "standard of review" making "clear" that the party giving the presumption is a "reviewing body." See *Concrete Pipe & Prods. of California, Inc. v. Construction Laborers Pension Trust*, 508 U.S. 602, 621-25 & n.15 (1993). Suspending the publication of decisions under review does not change a reviewing court's function any more than keeping circuit court decisions secret would change the appellate nature of this Court's work.[6]

2. Respondent's "no deference" argument flies in the face of the plain language of Rule 183.[7] Phrases such as "due regard" and "presumed to be correct" plainly suggest clear error review.

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[6] Nothing in the Fifth Circuit's decision in *Freytag v. Commissioner*, 904 F. 2d 1011, 1015 n.8 (CA5 1990), *aff'd on other grounds*, 501 U.S. 868 (1991) – the only case on which Respondent relies – supports its position. That case did not involve the Tax Court Judge *failing* to give deference to the findings of the Special Trial Judge. Rather, the objection was that the Chief Judge had adopted a Special Trial Judge's Report as the opinion of the Tax Court on the very same day that the Report was filed by the STJ, thereby giving *too much* deference to the STJ. See *id.* at 1015. In rejecting that claim, the Fifth Circuit did not remotely suggest that *no* deference was now due the STJ's report, nor did it say, as Respondent misleadingly suggests, that "review by a regular judge of a special trial judge's report is not an appellate review but is an exercise of the regular trial judge's original factfinding authority." Br. in Opp. 11 n.2. Indeed, the *Freytag* court specifically noted that "Tax Court Rule 183(c) indicates that the special trial judge's recommended findings of fact shall be presumed correct." 904 F. 2d at 1015 n.8.

[7] *Cf. Pavelic & LeFlore v. Marvel Entertainment Group, Div. of Cadence Indus. Corp.*, 493 U.S. 120, 123 (1989) ("We give the Federal Rules of Civil Procedure their plain meaning. . . ."); *Walker v. Armco Steel Corp.*, 446 U.S. 740, 750, n.9 (1980) ("The Federal Rules should be given their plain meaning.").

"Due regard" is universally used in the context of requiring clear error review. See, *e.g.*, FED. R. CIV. PRO. 52(a) ("Findings of facts . . . shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."); RULES OF THE U.S. COURT OF FEDERAL CLAIMS 52(a) (same); FED. R. BANKR. PRO. 8013 (same). Respondent does not explain how "due regard" could translate to "no deference" here. Br. in Opp. 11.

This Court and lower courts (including the Tax Court) have consistently held that there is a "*presumption of correctness*" as to the IRS's determinations of tax deficiencies. This phrase is always used to mean that the taxpayer bears the burden of proving that the IRS erred.[8] Respondent does not explain how the same phrase – "presumption of correctness" – could mean both that courts *must* defer to the IRS's determinations *and* that the Tax Court is "*not to defer to*" STJs. Br. in Opp. 11.[9]

3. The decision below thus implicates a real and deepening split among the Circuits about the level of deference due to an STJ's Report and findings. For this reason alone, certiorari should be granted.

C. Respondent's Other Arguments Miss the Mark

Respondent argues that 26 U.S.C. § 7482 has been satisfied here, because an STJ's report is not the "decision" of the Tax Court, and only the final "decision" of the Tax

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[8] See, *e.g.*, *United States v. Janis*, 428 U.S. 433, 441 (1976); *Forte v. Commissioner*, 61 T.C.M. (CCH) 1754 (1991) ("Next, petitioner contends that the position taken by respondent in the notice of deficiency was clearly erroneous, thereby rebutting respondent's presumption of correctness. . . .").

[9] Nor does the Tax Court itself believe that no deference is due the STJ's Report. Indeed, it went out of its way to assure the parties that due regard and a presumption of correctness were given the STJ's Report. See Br. in Opp. 2a.

Court must be reviewed under Section 7482. Br. in Opp. 13. This argument misreads Section 7482, which provides that review must be conducted "*in the same manner and to the same extent*" as decisions of civil bench trials in district courts. Where a district court has employed a magistrate or special master, the reviewing appellate court will *always* be provided with that original set of fact-findings as part of the record. Pet. for Cert. 15-16. In order for Article III courts to review Tax Court decisions "*in the same manner and to the same extent*" as they would review district court decisions, they must have access to STJs' Reports.

Respondent claims that tax fraud trials are "public rights" cases. Br. in Opp. 12. Even so, the Constitution *always* requires effective Article III review. See, *e.g.*, Pet. for Cert. 23 (collecting numerous citations); *Crowell v. Benson*, 285 U.S. 22, 54 (1932) (noting that the statutory scheme "preserv[ed] [the courts'] complete authority to insure the proper application of the law."). Due process continues to apply to adjudications in the Tax Court and other Article I tribunals, and defendants accused of tax fraud have a due process right to see the original fact-finding report that exonerated them.

There have been no cases in the past 19 years in which the Tax Court indicated on the record that it had modified so much as a single word of an STJ's report. Br. in Opp. 14. Respondent points out, however, from 1976 to 1984, when STJ reports *were* provided to the parties, there were only twenty cases (out of 680) in which the Tax Court modified the STJ's report, and "only one" in which the STJ was reversed. (In fact, there were at least *two* such reversals prior to 1984, one of which was cited by Respondent earlier in its brief.)[10]

[10] The reversal that Respondent fails to cite here took place in *Rosenbaum v. Commissioner*, 45 T.C.M. (CCH) 825 (1983). This was the

(Continued on following page)

Thus, Respondent concedes that while the Tax Court formerly indicated on occasion that it had rejected or modified a STJ's report, the Tax Court has not made *any* such public acknowledgment for nearly two decades now. There are only three possible explanations: First, STJs and all other Tax Court judges always agree on every fact and legal conclusion, with no exception to be found. This is impossible. See *Kanter*, 337 F.3d at 876 (Cudahy, J., concurring in part and dissenting in part). Second, the Tax Court does nothing but rubber-stamp the opinions of STJs. But this contradicts the government's own claim that STJs are not allowed to "decide" cases and that the Tax Court gives *no* deference to STJs. Br. in Opp. at 11. Third, the Tax Court *does*, in fact, alter or reverse STJs' decisions, but without ever creating any public record. In fact, that is exactly what occurred in this case, as the undisputed evidence shows.[11]

Respondent points to what it claims is an analogous Tax Court procedure: when a case has been tried by a regular judge and then reviewed by the full Tax Court, the original opinion of the regular judge need not be made public. Br. in Opp. 10. Respondent then cites two cases (both of which predate *Raddatz*, 447 U.S. at 681) as

decision that the D.C. Circuit in turn reversed in *Stone*, on the grounds that the Tax Court had failed to give due deference to the STJ. Respondent cites *Rosenbaum* and *Stone* earlier, Br. in Opp. 11 n.2, but omits *Rosenbaum* on page 14.

[11] Notwithstanding the government's fine-toothed parsing of a Tax Court order, Br. in Opp. 13 n.3, the Commissioner's counsel conceded at the Eleventh Circuit's oral argument that there is no evidence whatsoever to dispute the sworn affidavit of Randall Dick, Pet. App. at 308a-10a, which describes the conversation in which *two Tax Court judges told him that Judge Couvillion's original result had been changed by the reviewing judge*. The government essentially concedes this point when it speculates that the STJ changed his mind between writing his original report and the issuance of the final Tax Court decision. Br. in Opp. 13 n.3. Judge Cudahy noted a similar concession by the government at the Seventh Circuit oral argument. See *Kanter*, 337 F.3d at 876 (Cudahy, J., concurring and dissenting in part).

holding that due process is not violated by this procedure. See Br. in Opp. 10, citing *Estate of Varian v. Commissioner*, 396 F.2d 753 (CA9 1968); *Heim v. Commissioner*, 251 F.2d 44 (CA8 1958). These cases are inapposite; they were decided not under Rule 183, but under 26 U.S.C. § 7460(b). "Review" under these two provisions is not the same thing. First, the relationship between a regular Tax Court judge and the full Tax Court is fundamentally different than the relationship between an STJ and the Tax Court. In the first instance, all of the judges are *peers*, while in the second instance, the STJ is an inferior, at-will employee whose work is supposed to be reviewed for clear error. See *Stone, supra*. Second, in each of these cases, the original trial judge was part of the full Tax Court that reviewed the case. Third, he or she was given the opportunity to dissent, and to have that dissent *fully incorporated* into the released opinion.[12]

* * *

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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[12] See *Varian*, 396 F.3d at 755 n.1 ("In this case, in fact, the one judge who constituted the division which heard the case dissented from the final decision of the full court on all issues that are relevant here."); *Heim*, 251 F.2d at 47 ("It appears from the dissenting opinions of Judge Opper and Judge Fisher that Judge Opper was the trial judge who heard the evidence.").

In this case, by contrast, there is no dissent by Judge Couvillion. Rather, the final opinion purports to be an adoption of his findings, even though two Tax Court judges acknowledged, in undisputed record evidence (see footnote 11, *supra*), that the conclusions and findings are not actually Couvillion's, and are certainly not his own *original* credibility determinations.

(3)

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IN THE

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CLAUDE M. BALLARD and MARY B. BALLARD,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF OF JOSHUA S. KANTER, AS EXECUTOR OF THE ESTATE OF BURTON W. KANTER, AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF AMICUS CURIAE

The petition for certiorari arises out of a single Tax Court trial over five weeks involving three taxpayers, including Burton W. Kanter.[1] Kanter, the main witness at trial, was one of the leading tax and estate lawyers in the country and taught for nearly 15 years as an adjunct at the University of Chicago Law School. Because the three taxpayers resided in different circuits, their appeals were taken to different Courts of Appeals. In Kanter's case, the Seventh Circuit sharply divided, 2-1, over whether the Tax Court's trial processes violated due process and other federal law. *Estate of Burton W. Kanter v. Commissioner*, 337 F.3d 833 (7th Cir. 2003). Kanter has sought *en banc* review, and the Seventh Circuit has required the government to answer Kanter's *en banc* petition. The Seventh Circuit's rules suggest a final determination on whether to grant the *en banc* petition no later than November 3, 2003.

Kanter, Claude Ballard, and Robert Lisle were found in the Tax Court to have engaged in concerted action to commit tax fraud. With respect to Lisle, the Fifth Circuit, per Judge Higginbotham, overturned the fraud judgment for lack of sufficient evidence. *Estate of Robert W. Lisle v. Commissioner*, 341 F.3d 364 (5th Cir. 2003). With respect to Ballard, the Eleventh Circuit panel upheld the fraud judgment and rejected Ballard's constitutional challenges. With respect to Kanter, the Seventh Circuit panel divided 2-1 on precisely the same constitutional issues presented in

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[1] Pursuant to Rule 37.6 of the Rules of this Court, *amicus* states that no person other than *amicus* and its counsel have made a monetary contribution to the preparation or submission of this brief. All parties have consented to the filing of this brief.

Ballard.

Kanter has a direct and obvious interest in this Court's determination whether to grant certiorari in *Ballard*. Resolution of these issues in *Ballard* could materially affect subsequent judicial treatment of those issues in *Kanter*. Kanter has a significant interest, in the alternative, in this Court holding the petition in *Ballard* for a short time pending the Seventh Circuit's decision on whether to grant *en banc* review. Holding *Ballard* for this period will afford this Court a complete record and final judgment in all Courts of Appeals on the substantial constitutional issue that has divided lower court judges.

STATEMENT

1. The fundamental issue in this case is whether the trial structure of the Tax Court violates due process or other federal law. *Amicus curiae* seeks to highlight one critical fact about the proceedings below. The Tax Court employs trial judges but keeps secret their legally binding and "presumptively correct" findings of fact. Tax Court decisions are legally required to rely upon these findings, but these findings are not, at any time, made part of the public record of the case. Neither the taxpayer, the government, nor the reviewing Court of Appeals is given access to the trial judge's "presumptively correct" findings of fact and credibility judgments. Yet these findings form the basis, in part, of the Tax Court's decisions.

The Courts of Appeals are legally obligated to ensure that Tax Court findings of fact are supported by the evidence and not clearly erroneous. But the appellate courts cannot adequately perform this function because they do not have access to the findings

of the judge who presided at trial. This non-transparent process of decisionmaking is challenged in the *Ballard* and *Kanter* cases as violating the due process rights of taxpayers and the statutory obligations of the Tax Court. Those statutory obligations include that "all reports of the Tax Court . . . shall be public records." 26 U.S.C. § 7461(a).

In *Kanter*, the Seventh Circuit panel divided 2-1 on both the constitutional and statutory issues. In an extensive, 28-page dissent, Judge Cudahy concluded that the Tax Court's decision-making structure is indeed unconstitutional. The Seventh Circuit opinions focus considerably greater attention on these issues than does the Eleventh Circuit in *Ballard*.

2. Tax Court Special Trial Judges (STJs) preside over many complex and financially significant cases, including those involving allegations of fraud. The Tax Court consists of up to 19 regular Tax Court judges presidentially appointed for 15-year terms and removable only for cause. 26 U.S.C. § 7443. The Tax Court also includes 10 STJs. An STJ is appointed at the discretion of the Chief Judge; has no statutorily mandated term of office; and serves at the pleasure of the Tax Court. 26 U.S.C. § 7443A. The Chief Judge can assign any case, "regardless of complexity or amount," to an STJ for trial and initial findings of fact, credibility judgments, and proposed decision. *Freytag v. Commissioner*, 501 U.S. 868, 877-80 (1991); 26 U.S.C. § 7443A(b)(5). An STJ exercises "significant governmental authority" and hence is an inferior officer of the United States who can be appointed (unlike a law clerk, a mere employee) only in accord with Article II of the Constitution. *Freytag*, 501 U.S. at 880-82. This

case addresses the implications of *Freytag*. Now that STJs preside over numerous cases of great complexity and large amount, the Tax Court's treatment of the trial judge's findings and credibility judgments has become all the more important.

3. The constitutional issues presented in this case arise from a complex civil tax fraud case, which was tried for nearly five weeks in the Tax Court before an STJ. Credibility judgments were critical. Sixty witnesses testified; the STJ asked questions of 40 of those witnesses. In such a case, as Judge Cudahy observed, "[t]he detailed interconnection of the credibility of different witnesses on different factual issues makes the accumulated impressions of the presiding officer irreplaceable." *Kanter*, 337 F.3d at 886. After working more than four years post-trial to prepare a report, the STJ filed his report, including his findings of fact and proposed opinion.

This Rule 183 report must be prepared by the STJ and filed with the Chief Judge under the Tax Court's own rules. T.C. Rule 183(b). The Chief Judge then assigns the case to a reviewing Tax Court judge. The Rule 183 report has direct, operative legal effect.

Rule 183 requires that: "Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." T.C. Rule 183(c). The United States Court of Appeals for the District of Columbia Circuit, in an opinion by Judge Williams, has construed "due regard" to permit the Tax Court to overturn a trial judge's findings only if those findings can be shown to be "clearly erroneous." *Stone*

v. Commissioner, 865 F.2d 342 (D.C. Cir. 1989). The Courts of Appeals must ensure that Tax Court reviewing judges adhere to the limits on their review power. 26 U.S.C. § 7482. Subject to the "presumptively correct" and "due regard" constraints, the reviewing judge can adopt, modify, or reject, in whole or in part, the trial judge's report. T.C. Rule 183(c). The reviewing judge has no first-hand knowledge of the trial or the testimony. The reviewing judge also need not (and in this case, did not) hear argument or receive additional briefs. *Id.* There is no dispute that the "due regard" standard binds the reviewing judge and imposes a legal constraint on the reviewing judge's authority to overturn the trial judge's findings.

Before 1983, Tax Court rules *required* the routine disclosure of the STJ's report. *See* T.C. Rule 182(b), 60 T.C. 1149 (1973). But without any explanation, the Tax Court then amended the rule to eliminate disclosure of the trial judge's legally required report. 81 T.C. 1070 (1983) (renumbering as Rule 183). Thus, the Tax Court now adopts the position that, as a per se matter, it will refuse to make the trial judge's report part of the record. As far as *amicus* is aware, the Tax Court is, as Judge Cuhady observed, "unique among all the institutions in the law" in claiming the power to refuse to disclose the "presumptively correct" findings of fact of a trial judge or hearing officer. *Kanter*, 337 F.3d at 874. The Tax Court prohibits the trial judge's report from being made available in any litigation context, at any stage of the proceedings, to any actor outside the Tax Court. Even in a civil tax fraud case where credibility findings are critical, it is impossible for the

Courts of Appeals upon review to take the trial judge's "presumptively correct" findings in the Rule 183 report into account in any way.

4. The government, on behalf of the Tax Court, defends the following process: after the trial judge files the legally operative Rule 183 report, the reviewing judge and the trial judge may discuss the findings of fact and credibility judgments. If the reviewing judge disagrees with the trial judge's initial findings, the reviewing judge can privately "persuade" the trial judge (employed at the pleasure of the Tax Court) to jointly sign a new opinion with modified or alternative findings. This reversal of the "presumptively correct" findings filed in the Rule 183 report is never reflected in the record. The trial judge's findings and Rule 183 report remain secret, even from the reviewing court. Instead, the Tax Court issues a final decision that always (as in this case) starts with the following boilerplate: the Tax Court judge "agrees with and adopts the opinion of the special trial judge." Like Judge Cudahy in the Seventh Circuit, *amicus* has been unable to find a single case without exactly this formulaic language in the nearly 900 Tax Court decisions decided pursuant to 26 U.S.C. § 7443A(b)(5) or its predecessor since 1983. *Kanter*, 337 F.3d at 876. This unbroken pattern explains why the government acknowledges that reviewing judges do regularly modify or reject findings of fact, but behind the scenes in a way that leaves no trace in the public record.

The government concedes that this boilerplate language does *not* mean that the reviewing Tax Court judge has accepted the original STJ's findings of fact and credibility judgments in the Rule 183 report.

Instead, the reviewing judge "adopts the opinion" (not the "report," the legally specified term of art under Rule 183) of the trial judge *after* the findings of fact have potentially been modified or even overturned. There is no way for the reviewing Court of Appeals, the taxpayer, or the government to know whether, in fact, any such modifications have taken place in any specific case. As Judge Cudahy concluded in the Seventh Circuit, "I do not believe that the concealment of the Tax Court's revision process behind that [boilerplate] verbal formula allows this court to conduct meaningful appellate review." *Kanter*, 337 F.3d at 888.

5. In this case, the trial judge's Rule 183 report was before the reviewing Tax Court judge for 15 months. According to uncontradicted, sworn testimony, both the Chief Special Trial Judge and a Tax Court judge, perhaps outraged by the secret reversal of the trial judge's credibility findings, came forward to assert that the trial judge's Rule 183 report findings had been reversed outside the record.[2] Indeed, "those sections containing findings related to the credibility of witnesses and findings related to fraud were wholly contrary to the findings made by [the trial judge] in his report."[3]

6. The government's position is that as long as the trial and reviewing judges purportedly "agreed" at the

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[2] Tax Court counsel filed an uncontradicted affidavit testifying to these statements. *Declaration of Randall G. Dick*, App. at 1a. Counsel did not raise these statements in his first two motions seeking disclosure; only after these two motions were denied did counsel believe his legal obligations to his client required testifying to these statements.

[3] *Id.* ¶ 5.

end of the day to a second document – the final opinion of the Tax Court – then the first document – the Rule 183 report – need not and cannot be disclosed. The government asserts that Tax Court trial judges are the equivalent of law clerks and the Rule 183 reports tantamount to bench memos. This despite the fact that the Rule 183 reports have legally operative effect and include "presumptively correct" findings of fact and critical credibility judgments.

Prior to this case, the Tax Court bar and the Courts of Appeals had no way of knowing that the Tax Court operated in the way that this litigation has revealed. That revelation has produced considerable furor in the Tax Court bar. Many commentators argue that the Tax Court process violates due process.[4] In *Kanter*, Judge Cudahy dissented at length to agree with that conclusion. The Seventh Circuit is currently considering whether to review that issue *en banc*.

REASONS FOR GRANTING OR HOLDING THE PETITION

The constitutional question of whether STJ reports must be disclosed is of exceptional practical and national importance. Since this Court's decision in *Freytag*, STJs have come to be used more frequently in some of the financially largest and most complex cases before the Tax Court. In *Freytag* itself, the amount at stake was $1.5 billion. 501 U.S. at 871 n.1. This case involves one of the most complex cases before the Tax

[4] *See* Gerald A. Kafka & Jonathan Z. Ackerman, *Fact-Finding in the Tax Court: Access to Special Trial Judge Reports*, 91 Tax Notes 639, 642 (Apr. 23, 2001); Cornish F. Hitchcock, *Public Access to Special Trial Judge Reports*, 2001 Tax Notes Today 199-41 (Oct. 15, 2001).

Court. The trial took five weeks, the amount currently at issue is at least $45 million, and witness credibility was critical on the dispositive, complex issues of intent and fraud. Since 1983, around 900 cases have been tried to STJs employing the procedures used here.

Secret trial judge reports violate this Court's precedents on the constitutional role of factfinding, credibility judgments, and appellate review in judicial and administrative processes. In addition, Tax Court secrecy of this sort violates the federal statutes governing Tax Court proceedings and appellate review. Only this Court's review can bring uniformity and transparency to a process of adjudication in the Tax Court that offends core due process principles, involves enormous financial and personal stakes, and affects cases in every Court of Appeals. Resolution of the issues presented here also has direct implications for the role of hearing officers, administrative law judges, and other finders of fact in administrative proceedings and Article I courts. As Judge Cudahy recognized in the Seventh Circuit, the constitutional issue raised here affects "the whole administrative array of the federal government;" if the decision below is not reversed, it will lead agencies throughout the government to conclude that they may "deny transparency when engaging in like decisional processes" to those the Tax Court uses here. *Kanter*, 337 F.3d at 875.

As an alternative to granting the *Ballard* petition at this stage, the Court should hold *Ballard* until the Seventh Circuit acts upon the *en banc* petition in *Kanter*. The due process issue is the focus of the 2-1 division within the Seventh Circuit panel. Given the length and forcefulness of Judge Cudahy's dissent,

there is obviously strong disagreement in the Seventh Circuit on the fundamental constitutional issue raised here.

A brief hold in *Ballard* will afford this Court the benefit of full lower-court analysis of a substantial constitutional issue that already is dividing lower-court judges.[5]

I. THE TAX COURT'S DECISIONMAKING PROCESS VIOLATES ELEMENTAL PRINCIPLES OF DUE PROCESS

The final decision of the Tax Court *depends*, in part, on an undisclosed trial judge's report that has legally operative effect under the "due regard" standard of Rule 183. That report is part of the "private record" of the case, but not the public record. This practice – inconsistent with every federal agency or court of which *amicus* is aware – surely violates due process, particularly in a tax fraud trial where credibility is critical.

This process violates a taxpayer's due process rights to a fair initial trial and adequate appellate review. Because constitutionally protected property and liberty interests are at stake in a tax fraud trial, the three-part test of *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976) and *United States v. Raddatz*, 447 U.S. 667, 677 (1980) must be applied for determining the process required. That familiar test requires an assessment of (1) the private interests at stake; (2) the extent to which decisionmaking accuracy will be enhanced by

[5] The government acknowledged the importance of co-ordinating judicial treatment of *Ballard* and *Kanter* in its motion for an extension of time to file its *en banc* answer in *Kanter*. *See* App. at 4a.

providing the procedure at issue; and (3) the public interests implicated by the procedure at issue. In this context, the second part of this standard is critical: whether disclosure of the trial judge's report will significantly enhance the accuracy of the overall decisional process. This Court has long recognized the common-sense principle that accuracy is substantially enhanced by including the trier of facts' findings and credibility judgments in the public record. Analysis of the due process issue must be informed by this Court's decisions on the legal role of factfinding and credibility judgments in judicial and administrative decisionmaking.

Disclosure of the findings of a trial judge, hearing officer, or analogous initial factfinder is such a fundamental premise of fair and proper judicial and administrative process that *amicus* has been unable to find *any* area in modern law, outside the Tax Court, where such disclosure is not routine. "As this Court has stated from its first due process cases, traditional practice provides a touchstone for constitutional analysis" of due process issues. *Honda Motor Co. v. Oberg*, 512 U.S. 415, 430 (1994) (citations omitted). Transparency of agency and judicial decisionmaking has long been a fundamental premise of American practice. Even the Administrative Procedure Act (APA) -- which applies to the less formal processes of agencies, not to courts such as the Tax Court which are presumably held to even higher standards -- requires that the record on review must include any preliminary findings from a hearing officer or administrative law judge, regardless of whether the agency has *de novo* power over facts. 5 U.S.C. §§ 557(b), 706. The

framers of the APA considered this a critical requirement, particularly "on matters which the hearing commissioner, having heard the evidence and seen the witnesses, is best qualified to decide. . . ."[6] As Judge Cudahy noted in *Kanter*, "[w]hen a reviewing court reviews agency findings on credibility for substantial evidence, it is strongly influenced by the preliminary findings of the ALJ who actually heard the witnesses – influence that becomes even more significant when an agency has reversed those preliminary credibility findings." *Kanter*, 337 F.3d at 885.

Congress has also required that the report of a magistrate judge (who, unlike the STJ here, may be employed only with the consent of the parties) be served on the parties and be part of the record. That is so even though the District Court has greater legal authority in reviewing a magistrate's actions than the Tax Court does in reviewing the "presumptively correct" findings of its trial judges. Unlike the Tax Court, which is legally bound to treat its trial judge's findings as presumptively correct, a District Court can make *de novo* factual findings on certain matters a magistrate addresses. *See* 28 U.S.C. § 636(b)(1). Similarly, a bankruptcy judge's initial findings of fact are part of the record and cannot be set aside upon review in the District Court unless clearly erroneous; the District Court must also specifically give "due regard . . . to the opportunity of the bankruptcy court to judge the credibility of the witnesses." Fed. R. Bankr. P. 8013. The reports of Special Masters, including findings of fact where required, must be filed with the

[6] Final Report of Attorney General's Committee on Administrative Procedure 51 (1941).

clerk of the court; the parties must be notified of this filing. Fed. R. Civ. P. 53(e)(1). *See also* Fed. R. Civ. P. 52(a).

This Court, Congress, and the lower federal courts have thus consistently concluded that the accuracy, accountability, and integrity of administrative and judicial proceedings require including in the record the initial findings of any preliminary factfinder. That is so even for routine matters in which constitutionally-protected liberty and property interests are not at stake. That must be all the more so in a tax fraud trial, in which constitutionally-protected property and liberty interests are implicated. Decisionmaking accuracy, within the meaning of *Mathews*, demands disclosure of the Rule 183 report. That would be so even if the Tax Court were not required to treat the findings in that report as "presumptively correct." Given that these findings *do* legally constrain the reviewing Tax Court judge, it is clear that accurate decisionmaking and review is not only enhanced but only made possible by disclosing a report that forms the basis for the Tax Court's decision. Because the added public cost of disclosure is de minimis — if transparency is a cost at all, as opposed to a benefit — *Mathews* requires disclosure.

Due process protections for factfinding are even more enhanced when, as here, credibility is at issue. *Raddatz* makes clear the constitutional dimensions surrounding the overturning of a trier of fact's credibility judgments. *Raddatz* involved the relationship between the District Courts and magistrates in suppression-hearing contexts when the magistrate has conducted a hearing and made credibility

judgments. In that context, this Court suggested, and the lower courts have consistently concluded, that due process is violated if a District Court overturns a magistrate's findings on credibility without hearing the witnesses. 447 U.S. at 681 n.7; *see, e.g., Cullen v. United States*, 194 F.3d 401, 406 (2d Cir. 1999) (Newman, J.) (due process violated when District Court without hearing witnesses rejects Magistrate's credibility findings regarding plea bargain); *Hill v. Beyer*, 62 F.3d 474, 482 (3d Cir. 1995); *In re Hipp, Inc.*, 895 F.2d 1503, 1519-21 (5th Cir. 1990). If the District Judge cannot constitutionally reverse credibility judgments without hearing the witnesses, it goes without saying that the magistrate's report must also be part of the record. The decision below conflicts with *Raddatz* and these decisions of the Courts of Appeals and for that reason alone requires this Court's review.

To protect the STJ's factfinding role on credibility and other matters, the trial judge's report must similarly be part of the record. This Court's substantive emphasis on the role of credibility findings in proper adjudicative processes surely requires the procedural measure of including in the record the findings and credibility judgments of the STJ who presided over the trial. *See Anderson v. City of Bessemer City, N.C.*, 470 U.S. 564, 575 (1985) ("When findings are based on determinations regarding the credibility of witnesses, [the clearly erroneous standard] demands even greater deference to the trial court's findings . . . ."); *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 496 (1951) ("[E]vidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case

has drawn conclusions different from the Board's than when he has reached the same conclusion . . . . The significance of [the presiding judge's or examiner's] report, of course, depends largely on the importance of credibility in the particular case.") (Frankfurter, J.).

This case highlights how essential the trial judge's findings are to preserve due process and the right to adequate appellate review. Intent and credibility are critical elements in this tax fraud case. To establish fraud, the government must prove by clear and convincing evidence that underpayment occurred with the intent to evade taxes that the taxpayer knew or believed to be owed. This case involves three taxpayers who the government claims were involved in a conspiracy to commit tax fraud. But the Court of Appeals for the Fifth Circuit, in an opinion by Judge Higginbotham, has already held clearly erroneous the Tax Court's fraud judgment in this very case with respect to one of the purported "co-conspirators." *Estate of Lisle v. Commissioner*, 341 F.3d 364 (5th Cir. 2003). In addition, in upholding the Tax Court's findings against Kanter, the Seventh Circuit at least eight times gave central importance to the Tax Court's purported judgments regarding Kanter's credibility or his "intent." Indeed, the divided panel held that "the lack of credibility of Kanter's testimony," which the Tax Court purportedly found, was a central justification for upholding the judgment of fraud. *Kanter*, 337 F.3d at 846. Yet undisputed record evidence shows that the actual trial judge found that Kanter and Ballard were in fact credible and had no intent to defraud. Those original findings and the reasons the reviewing judge gave for overturning them are, at the least, *relevant* –

indeed, they would likely be critical – to federal appellate review of Tax Court decisions.

Before this case, the Tax Court's procedure was itself shrouded in secrecy. Neither the Tax Court rules nor any other document of the Tax Court of which *amicus* is aware publicly described this policy. The government's briefs remained enigmatic. The Eleventh Circuit mistakenly thought petitioners' arguments were moot because the trial judge ultimately signed the second document, the final Tax Court opinion.

But the view that the due process issue is moot misunderstands the essential constitutional challenge here. That challenge does not depend on whether the Tax Court reviewing judge and the special trial judge (who is employed at will by the Tax Court) can appropriately be characterized as "agreeing" at the end of the day — even assuming there were any way of knowing or determining this fact. The Rule 183 report, legally required, is itself a legally operative document whose "presumptively correct" findings of fact must be given "due regard." There is a world of difference between a factfinder committing findings to the record, with those findings then reviewed under the appropriate standard, and a factfinder negotiating and modifying those findings in secret with a reviewing judge under an unknowable standard of review not capable of being judicially enforced. The integrity of the legal process — and hence due process itself — depends on a differentiation between the roles and functions of different legal actors, such as factfinders and reviewing judges.

The Tax Court must comply with its own rules, and the federal courts must ensure that the Tax Court

has done so. *See, e.g., Service v. Dulles*, 354 U.S. 363, 388 (1957). It is not a lawful process for the trial and reviewing judges to negotiate their own private understanding of what "due regard" means, and whether it has been given, and then make these determinations unreviewable. No court can just announce that it "has complied with all legal requirements" and, by that bare proclamation, insulate its decision from all appellate review.

Moreover, as Judge Cudahy's dissent in the Seventh Circuit analyzed in detail, the structural imbalance of power between an at-will trial judge and the Tax Court makes any purported final "agreement" between trial and reviewing judge too shaky a foundation on which to rest the due process rights of taxpayers. In nearly 900 cases since 1983, not a single disagreement between an STJ and reviewing judge has ever emerged on the record. Whether this unbroken pattern reflects genuine agreement or the fact that STJs serve at the pleasure of the Tax Court is not a question on which this Court need speculate. Either way, the Rule 183 report must still be made part of the record.

II. FEDERAL STATUTES REQUIRE DISCLOSURE OF THE TRIAL JUDGE'S FINDINGS

The Tax Court practice also violates the federal statutes that govern the Tax Court. See 26 U.S.C. §§ 7459, 7461, and 7462. Section 7461(a) requires that "all reports of the Tax Court . . . shall be public records." The STJ's Rule 183 report is such a report, as the plain language of Rule 183 itself recognizes. *See* T.C. Rule 183(b) (requiring preparation and filing of the "Special Trial Judge's Report"). The statutory text

does not exempt the STJ's Rule 183 report from the statute's disclosure requirements. The plain language of Section 7461(a) therefore requires that this report be a public record. Similarly, Section 7459(b) requires that "[t]he Tax Court shall report in writing *all* its findings of fact, opinions, and memorandum opinions" (emphasis added). The Rule 183 report includes findings of fact and opinions of the Tax Court. In addition to the plain language of the statutes, the general purposes of these statutes reflect a not surprising congressional policy commitment to transparency in Tax Court adjudications. The Tax Court's refusal to disclose the findings of its trial judges is flatly inconsistent with the text and purposes of these statutes. In light of the constitutional problems otherwise presented, these statutes should be construed, as Judge Cudahy in the Seventh Circuit also concluded, to require disclosure of the Rule 183 trial judge's report. *See Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988).

In addition, Congress has assigned the Courts of Appeals the duty to review decisions of the Tax Court. *See* 26 U.S.C. § 7482. That appellate obligation must include the ability to review the legally relevant record as a whole. Findings of fact that are legally binding on the Tax Court, that form part of the basis for decision, but that are secret and not part of the record on review preclude the Courts of Appeals from performing their statutorily-assigned role. In light of the serious constitutional questions at stake, the appellate review statute should also be construed to require disclosure of the Rule 183 report.

III. THE PETITION FOR WRIT OF CERTIORARI SHOULD, IN THE ALTERNATIVE, BE HELD

This case and *Kanter* arise from the same underlying Tax Court decision and raise the same legal issues. The Seventh Circuit is scheduled to issue a determination whether to grant the pending petition for rehearing in *Kanter* no later than November 3, 2003. Seventh Circuit Operating Procedure No. 5. This Court should hold *Ballard* until the Seventh Circuit acts on the pending *en banc* petition. In essence, the appellate court proceedings reviewing the Tax Court action are not yet concluded; this Court should await a "final order" of the Seventh Circuit before acting on the *Ballard* petition. Counsel for Ballard have filed a letter with the clerk of this Court making a similar request.[9]

A short hold of this petition until the Seventh Circuit rules on rehearing would give this Court the benefit of full lower-court analysis and consideration of the constitutional questions raised here. The petition for certiorari should therefore be held pending the Seventh Circuit's ruling on the *Kanter* rehearing petition. If the Seventh Circuit denies the *Kanter* rehearing petition, Kanter intends to file a petition for writ of certiorari expeditiously.

CONCLUSION

The petition for writ of certiorari in *Ballard* should be granted. Alternatively, the Court should hold that

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[9] The fraud judgment in *Lisle* was held clearly erroneous in the Fifth Circuit, resulting in a reversal of most of the deficiency and penalties assessed against the *Lisle* estates by the Tax Court. The time in which a petition for certiorari can be filed in *Lisle* will expire on October 28, 2003.

petition until the Seventh Circuit acts on the pending *en banc* petition in *Kanter*. The Court should then consider the *Ballard* petition and any petition in *Kanter* together.

Respectfully submitted,

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October 6, 2003

APPENDIX

APPENDIX A — DECLARATION OF RANDALL G. DICK DATED AUGUST 21, 2000

UNITED STATES TAX COURT

Docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93 and 25981-93

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, et al.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECLARATION OF RANDALL G. DICK

Randall G. Dick, for his Declaration under penalty of perjury, pursuant to 28 U.S.C. § 1746, states as follows:

1. I am of full age, and if called to testify, would be competent to give the testimony as to the following matters.

Appendix A

2. I am counsel for Investment Research Associates, Ltd. and Subsidiaries and for Burton and Naomi Kanter.

3. In its Opinion in this matter filed on December 15, 1999 (T.C. Memo 1999-407) the U.S. Tax Court concluded, with respect to Issue 1, that payments made by Hyatt, Frey, Schaffel, Schnitzer and Eulich (the "Five") were taxable to the individual Petitioners and the individual Petitioners were liable for the fraud additions to tax and penalty with respect to such income. (Opinion, 226-319).

4. Subsequent to the issuance of the Tax Court's Opinion, Declarant was informed by two judges of the Tax Court, that in his original report submitted to the Chief Judge pursuant to Rule 183(b), Special Trial Judge D. Irwin Couvillion concluded that payments made by the Five were not taxable to the individual Petitioners and that the fraud penalty was not applicable.

5. In my conversations with the judges of the Tax Court, I was told the following: That substantial sections of the opinion were not written by Judge Couvillion, and that those sections containing findings related to the credibility of witnesses and findings related to fraud were wholly contrary to the findings made by Judge Couvillion in his report. The changes to Judge Couvillion's findings relating to credibility and fraud were made by Judge Dawson.

Appendix A

6. Judge Dawson's revisions resulted in a finding that over nine million dollars is taxable to the individual Petitioners. This finding, based upon credibility of witnesses, results in liability of the individual Petitioners for tax, penalties and interest in an amount in excess of $30,000,000.

7. I confirmed the information in paragraphs 4 and 5 above with another judge of this Court, who informed me that, in fact, the Opinion was changed, and that to his knowledge, it was the first time the Tax Court had made an outright rejection of credibility findings made by a Special Trial Judge.

8. I was also told by a judge of the Tax Court that the changed sections of the report were written in such a way so that wherever there was the "slightest issue of doubt, it went against" the Petitioners.

I declare under penalty of perjury that the foregoing is true and correct and that this Declaration is executed in San Francisco, California on August 21, 2000.

s/ Randall G. Dick
RANDALL G. DICK

APPENDIX B — MOTION FOR EXTENSION OF TIME IN WHICH TO FILE ANSWER TO PETITION FOR REHEARING AND PETITION FOR REHEARING IN BANC DATED SEPTEMBER 12, 2003

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220

ESTATE OF BURTON W. KANTER, DECEASED, and NAOMI R. KANTER,

Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

MOTION FOR EXTENSION OF TIME
IN WHICH TO FILE ANSWER
TO PETITION FOR REHEARING
AND PETITION FOR REHEARING IN BANC

Comes now the Commissioner of Internal Revenue, by and through his counsel, and respectfully moves for an extension of time in which to file his answer to the petition for rehearing and petition for rehearing en banc in the above-entitled consolidated cases for a period of 21 days, from September 23, 2003, to and including October 14, 2003. In support of this motion, counsel states as follows:

Appendix B

1. The Commissioner's answer to the petition for rehearing and petition for rehearing en banc in the above-entitled case is currently due to be filed and served on or before September 23, 2003, and no request for an extension of time with respect to the answer has previously been sought.

2. The above-entitled cases are among a group of three cases that arose out of the same proceedings before the Tax Court, and which involve challenges to the procedures employed by the Tax Court in its use of special trial judges. The other two cases are *Ballard v. Commissioner* (S.Ct. No. 03-283), and *Lisle v. Commissioner* (5th Cir. No. 01-60639 through 01-60642). The Government's response to the petition for a writ certiorari filed in *Ballard* is due to be filed in the Supreme Court on October 6, 2003.

3. As a result of the filing of the petition for a writ of certiorari in *Ballard*, the Office of the Solicitor General now has responsibility over that case. Because the issue in *Ballard* and the above-entitled case are essentially identical, it will be necessary to coordinate with the Office of the Solicitor General in preparing the response to the petition for rehearing and rehearing en banc filed in the above-entitled cases. In order to allow for this coordination, an extension of time until a short period after the due date for filing of the response to the petition for a writ of certiorari in *Ballard* is needed for the Commissioner to file the answer to the petition for rehearing and rehearing en banc filed in the above-entitled cases.

4. In addition, I could not turn to preparation of a draft answer to the petition for rehearing and rehearing en banc immediately in any event due to the press of previously assigned work, including preparation of the brief for the United States in *Crigler v. Commissioner* (4th Cir. No. 03-1861), due on extension on September 18, 2003, and preparation of the draft brief in opposition to a petition for a writ of certiorari in *Shell Petroleum, Inc. v. United States* (S.Ct. No. 03-283), currently due to the Supreme Court on September 22, 2003, and for which we anticipate that an extension of time to October 22, 2003 will be sought.

5. We have today provided a copy of the foregoing motion, by facsimile (in addition to service thereof), to Richard H. Pildes, counsel for the appellants.

WHEREFOR, for the reasons stated, the Commissioner respectfully moves that the time for filing and serving his answer to the petition for rehearing and petition for rehearing en banc be extended from September 23, 2003, to and including October 14, 2003.

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Dated: This 12th day of September, 2003.

(4)

Supreme Court, U.S.
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No. 03-184

IN THE

Supreme Court of the United States

CLAUDE M. BALLARD, ET UX.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF *AMICUS CURIAE* OF SEN. DAVID PRYOR AND THE ESTATE OF ROBERT W. LISLE; THE ESTATE OF DONNA M. LISLE; THOMAS W. LISLE, INDEPENDENT CO-EXECUTOR; AMY W. ALBRECHT, INDEPENDENT CO-EXECUTOR, IN SUPPORT OF THE PETITION FOR CERTIORARI

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INTERESTS OF *AMICI CURIAE*[1]

Hon. David Pryor served as United States Senator from Arkansas from 1979 to 1996 and as a United States Representative from 1966 to 1973. While in the Senate, Senator Pryor served on the Senate Finance Committee, chairing a subcommittee with responsibility for oversight of the Internal Revenue Service. While in this position, he developed and introduced the first Taxpayer Bill of Rights which was enacted in 1988. See Omnibus Taxpayer Bill of Rights, Pub. L. No. 100-647, §§ 6226-35, 102 Stat. 3342, 3731. As a Member of the House of Representatives, Senator Pryor supported and voted for the Tax Reform Act of 1969, § 951, Pub. L. No. 91-172, 83 Stat. 730, which, in order to ensure neutrality and procedural regularity, removed the Tax Court (previously the Board of Tax Appeals) from the Executive Branch and transformed it into an Article I Court. See 115 Cong. Rec. H22809, 91st Cong. 2d Sess. (Aug 7, 1969) (roll call vote).

Senator Pryor's actions have been motivated by an abiding belief that taxpayers in the United States have basic rights, including the right to due process of law, a right that is infringed by the proceedings to which the taxpayers here have been subjected. In speaking on the floor of the Senate in support of his landmark 1988 legislation he said "The passage of the taxpayers' bill of rights will send, I think, a very clear message to our country and to all taxpayers, small and large, that taxpayers do in fact have certain basic due process rights . . . . " 134 Cong. Rec. S15073, S15074, 100th Cong. 2d Sess. (Oct. 7, 1988) (statement of Sen. Pryor).

---

[1] In compliance with Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part. No person other than *amici* or their counsel made a monetary contribution to the preparation or submission of this brief.

"Like any good citizen," he said, "I believe that everyone should pay his or her lawful share of taxes. That is the price of freedom. However, at the same time that we are allowing the IRS to be more intrusive into the lives of our citizens for the sake of compliance, we must also ensure that we maintain basic due process rights, which have eroded slowly but surely over these past two and one-half decades." 134 Cong. Rec. S4134, 100th Cong. 2d Sess. (April 15, 1988) (statement of Sen. Pryor). Senator Pryor seeks to put his views before this Court because of his conclusion that, despite his legislative efforts, the secret procedures now used by the Tax Court and at issue here deprive taxpayers of those basic rights.

Taxpayers Robert and Donna Lisle ("the Lisles") were parties in the Tax Court proceeding under review here. As provided for by 26 U.S.C. §7482(b)(1)(A), because of their legal residence the Lisles' appeal from the adverse decision of the Tax Court was heard by a different Court of Appeals, the United States Court of Appeals for the Fifth Circuit, in a different case than that under review by this Court. See *Estate of Lisle v. Commissioner*, 341 F.3d 364 (5th Cir. 2003).[2] In that case, even despite the unavailability of the Special Trial Judges' report in this case, the Court of Appeals concluded that the credibility and other judgments of the Tax Court were insufficiently supported by the evidence to sustain the finding of fraud against Robert Lisle that formed the basis for most of the tax deficiency and penalties assessed against the Lisles. The Lisles died during the pendency of their appeal. Their estates appear before this

[2] A third Circuit Court of Appeals, the Seventh, has also considered an appeal from the underlying Tax Court decision here. See *Estate of Kanter v. Commissioner*, 337 F.3d 833 (7th Cir. 2003). A petition for rehearing and rehearing *en banc* is now pending before that court. Counsel for *amici* previously represented Petitioners in seeking to file a brief *amicus curiae* at the petition for rehearing stage in that case.

Court as *amici curiae* because of the denial of due process that it is now clear was wrought by the routine practice of the Tax Court utilized in the proceeding in which the remaining deficiency against the Lisles – the amount of which remains to be determined on remand in their case – was assessed.

STATEMENT

1. This case presents a serious question of broad national importance involving the constitutionality of procedures routinely used by the Tax Court to impose substantial liability in the most serious class of tax cases it assigns to its Special Trial Judges. These procedures appear to have been deliberately hidden by that court and have only recently been acknowledged by the government – after the eleventh hour in this case – in oral argument in a separate Seventh Circuit appeal from the Tax Court decision at issue here, where the government clarified that it was not contesting that these procedures take place, but was, rather, defending their lawfulness. While a clear picture of the way in which the Tax Court has been operating came very late in the day – too late for consideration by the court below – even this last-minute concession by the Government drew a lengthy and thoughtful separate opinion in the Seventh Circuit from Judge Cudahy, in which he concluded that the procedures that led to the assessment of a tax deficiency in this very case violate the Constitution. See *Estate of Kanter v. Commissioner*, 337 F.3d 833, 874-88 (7th Cir. 2003) (Cudahy, J., concurring in part and dissenting in part).

These newly conceded procedures – unique in American law – by which the Tax Court decision was rendered in this case are utterly at variance with norms of procedural due process repeatedly articulated by this Court, and their ongoing use in this important class of cases is not contested. This matter therefore requires the urgent attention of this Court.

2. The Tax Court is an Article I court of record, precisely like the United States District Courts for the Virgin Islands and Guam, review of whose decisions is of course familiar to this Court. See 26 U.S.C. §7443; see also 26 U.S.C. §7441; 48 U.S.C. §1424. In much the same way the District Courts are permitted to appoint Magistrates, see 28 U.S.C. §631, the chief judge of the Tax Court "may, from time to time, appoint special trial judges . . ." 26 U.S.C. §7443A(a). The Chief Judge may assign any proceeding to a Special Trial Judge for trial. 26 U.S.C. §7443A(b). In a wide variety of proceedings, these Special Trial Judges are authorized to issue the opinion of the Tax Court. *Id.* §7443A(c).

In cases where the amount of the claimed deficiency exceeds $50,000.00, cases tried before a Special Trial Judge are subject, though, to the procedures detailed in Tax Court Rule ("Rule") 183. A separate rule provides the Special Trial Judge with authority to conduct trials, issue subpoenas, command production of evidence, rule on motions, conduct pretrial hearings, rule on evidentiary questions, and conduct similar proceedings. See Rule 181. Under Rule 183, after trial, briefs are to be submitted by the parties to the Special Trial Judge. Rule 183(a). He or she then "submits a report, including findings of fact and opinion" to the chief judge who assigns the case to one of the Tax Court Judges. Rule 183(b).

Rule 183(c) then provides: "The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions." Rule 183(c).

Importantly, Tax Court Rule 183 mandates that "[d]ue regard shall be given to the circumstance that the Special

Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." *Id.* Review of the Tax Court's ultimate decision is available in the Courts of Appeals, which, by statute, must "review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." 26 U.S.C. §7482.

3. This case was tried by Special Trial Judge Couvillion. The trial involved alleged deficiencies of millions of dollars; indeed, the deficiency assessed against Petitioners alone (including penalties) amounted to $1,316,648. See Pet. App. 2a. The trial took five weeks and it "generated almost 5000 pages of transcript, more than 4600 pages of briefs and thousands of exhibits consuming hundreds of thousands of pages." *Kanter*, 337 F.3d at 838.

As required by law, Judge Couvillion prepared a Report, including findings of fact, which was submitted to the Chief Judge of the Tax Court. The case was then assigned to Tax Court Judge Dawson. One year and three months later, the Tax Court issued its opinion. The opinion, recites boiler plate language asserting that it "agrees with and adopts the *opinion* of the Special Trial Judge." *Id.* at 839 (emphasis added). It became clear in the proceedings before the Seventh Circuit in *Kanter* that identical language appears in *every other reported Tax Court opinion in a case tried by a Special Trial Judge issued since the Rule requiring publication of the Special Trial Judge's Report was repealed in 1983.* See *Kanter*, 337 F. 3d at 875-876 (Cudahy, J., concurring in part and dissenting in part) ("there exists not a single Tax Court decision since the adoption of current Rule 183 where a Tax Court Judge has purported to modify or reverse a finding of a Special Trial Judge"). Judge Cudahy thus correctly concluded that it is "impossible" that this language means that the Tax Court Judge adopted the

original Report of the Special Trial Judge given that what is involved is "a system of arms-length appellate style review involving 39 independent individuals." See *id.* at 875-876 (Cudahy, J., concurring in part and dissenting in part).

Whatever this language means – and it appears to refer to an opinion arrived at after in-chambers discussion by the Special Trial Judge and the Tax Court Judge that may contain modifications to the Report, see *id.* at 875-76 (Cudahy, J., concurring in part and dissenting in part) – the Commissioner has never contended, and does not now contend, that the Tax Court adopted without modification the "*Report*" of the Special Trial Judge. See Rule 183 (emphasis added).

Undisputed record evidence demonstrates – and since oral argument in the *Kanter* case in the Seventh Circuit, the Commissioner clearly does not now deny – that, despite the boiler plate language in the Tax Court's opinion, findings of fact relating to the credibility of witnesses and to intent to defraud contained in Judge Couvillion's Report were reversed in the Tax Court opinion issued by Judge Dawson. Nonetheless, the Tax Court has refused to give the parties *or the Courts of Appeals,* including the court below, *even under seal*, a copy of the Special Trial Judge's Report – a Report containing findings mandated by law, and to which "due regard" and a "presumption of correctness" were due by law – so that those courts can assess whether the Tax Court followed the law in rendering its decision.

The basis of the decision below is that the Tax Court's final opinion is "in fact, Special Trial Judge Couvillion's Report." Pet. App. 9a. Indeed, the court below said that "Were that not to be the case, we, too, would have significant concerns over the propriety of the process employed in this case." *Id.*

As Judge Cudahy's opinion in the *Kanter* case makes clear, the true nature of the Tax Court's treatment of the Special Trial Judge's report only became clear with the Commissioner's refusal to deny at oral argument that the procedure was as described in the text. It seems irrefutable that the factual premise of the panel's conclusion is wrong, though given the opacity of the Commissioner's position in this case in the court below, the court's error would certainly be more than understandable.

Nor is the procedure now defended by the Commissioner the alternative one described approvingly by the court below in dictum, in which "judges confer with one another . . . when more than one judge is charged with responsibility for the case." *Id.* Rather, as described in more detail below, it is now clear that this is a case of a reviewing judge conferring *ex parte* with the judge who made the determinations under review and of the reviewing court refusing even to make public the original determinations committed by law to that latter judge. As this Court well knows, it is "impossible" that different combinations of two judges with joint responsibility for deciding cases will agree in every one of several hundred reported decisions. *Cf. Kanter* 337 F. 3d at 875 (Cudahy, J., concurring in part and dissenting in part). The proceedings in *Kanter* reveal that what actually takes place in the Tax Court is not the alternative procedure the court below hypothesized.

The Government's Brief in Opposition here permits the Commissioner the opportunity to deny that the procedure is as we have described (and, for that matter, to deny that the Tax Court misleadingly refers to adoption of an "opinion" of the Special Trial Judge even when it does not adopt, but modifies, the Report of the Special Trial Judge that contains the determinations committed to him by law). The Commissioner will have the opportunity to explain how the Tax Court procedure actually works. We have no doubt that

the Commissioner will not deny it, but will defend the procedure as we describe it.

ARGUMENT

1. The Courts of Appeals Cannot Consistent with Due Process Undertake Appellate Review of the Tax Court's Findings without Access to the Special Trial Judge's Report.

a. The Courts of Appeals are bound by law to review the Tax Court's findings of fact, including its finding of fraudulent intent here, for clear error. See, *e.g.*, *Pittman v. Commissioner*, 100 F.3d 1308, 1312-1313 (7th Cir. 1996). As Judge Cudahy said in his opinion dissenting in part in *Kanter*, "it is integral to the standard of clear error review that there be deference to the credibility findings of the official who has actually heard the witnesses." 337 F. 3d at 884-885 (Cudahy, J., concurring in part and dissenting in part).

Here, by keeping secret the Special Trial Judge's report, the Tax Court has denied the court below the very ability to examine those findings. Thus, as Judge Cudahy concluded, even if the Tax Court owes no deference to the Special Trial Judge's findings – so that it may itself somehow make findings of credibility *de novo* without hearing or seeing witnesses – the court below could not consistent with the requirements of due process review those findings for clear error without examining the original credibility determinations contained in the Special Trial Judge's Report. See *id.*

This Court has made clear, as a bedrock principle of our legal system, that Due Process is violated when a court is unable to perform the adjudication required of it on appellate review because it is not provided with materials that are

necessary for it to make the determination committed to it by law. See *Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California*, 508 U.S. 602, 618 (1993) (Due Process requires "a neutral and detached *adjudicat[ion]*.") (emphasis added); *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 433-434 (1982) (determination of a cause without "the opportunity to present [the] case and have its merits fairly judged," violates Due Process); *Evitts v. Lucey*, 469 U.S. 387, 393 (1985) (requirements of due process apply to appellate courts). Due process, that is, requires that a court adjudicating a case be permitted to do so on its merits. *E.g.*, *Logan* at 429. The refusal of the Tax Court to permit examination of the Special Trial Judge's Report prevents the Courts of Appeals from doing so.

b. Tax Court Rule 183 (c) provides "Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Rule 183(c). The Courts of Appeals are, of course, bound to review decisions of the Tax Court for compliance with law, including compliance with Rule 183. See 26 U.S.C. §7453; see also, *e.g.*, *Service v. Dulles*, 354 U.S. 363, 388 (1957) (agency must comply with its own regulations).

Rule 183(c) by its plain terms commands some level of deference by the Tax Court to the Special Trial Judge's findings of fact. It is impossible for a Court of Appeals to determine whether a presumption of correctness has been given to the Special Trial Judge's findings of fact or due regard given to the Special Trial Judge's opportunity to evaluate the credibility of witnesses if that Court of Appeals is prevented, as the court here below was, from ever seeing those findings of fact. Again, appellate review for compliance with law where the reviewing court is not

provided with material necessary for it to make that determination violates Due Process. See *Concrete Pipe*, 508 U.S. at 618; *Logan*, 455 U.S. at 433-434.

c. The extraordinary nature of what goes on in the Tax Court can be seen in the remarkable order issued by the Tax Court when it refused to release Judge Couvillion's Report. The Tax Court actually asserted that "Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and . . . gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses." Tax Court Order of Aug. 30, 2000 (reprinted at Pet. 4-5 n. 3).

It is unimaginable that this Court would find as a matter of due process that a similar statement by a District Court (*e.g.*, "The judgment of this court is supported by the evidence.") provided a sufficient basis for Court of Appeals review of that court's judgment. And by law, the Courts of Appeals are to "review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." 26 U.S.C. §7482.

"Trust us, we did it right" is not an adequate basis for appellate review, and appellate review that can amount to nothing more than acceptance of such an assertion violates Due Process.[3]

---

[3] The Tax Court procedure independently violates Article III of the Constitution. That provision vests in the Courts of Appeals the "judicial power" of the United States. In denying the possibility for meaningful adjudication of the questions of whether there is clear error in the Tax Court's findings of fact and whether that court has complied with the command of Rule 183, the refusal to provide the Special Trial Judge's original report so that it can be reviewed by this Court violates Article III. The procedure used by the Tax Court under which the Report is not available to the Courts of Appeals "remove[s] '"the essential attributes of the judicial power,"' from th[ose] Article III tribunal[s]." *Thomas v. Arn*, 474 U.S. 140, 154 (1985) (citations omitted).

2. This Case Implicates A Split in Authority concerning the meaning of Tax Court Rule 183 (c).

The proper and complete determination of this case requires an authoritative construction of Rule 183(c). By its plain terms that Rule commands some level of deference by the Tax Court to the Special Trial Judge's findings of fact. That is what the D.C. Circuit has held, see *Stone v. Commissioner*, 865 F.2d 342 (D.C. Cir. 1989), and it is a premise of one part of our constitutional argument here: It is impossible to determine whether a presumption of correctness has been given to the Special Trial Judge's findings of fact or due regard given to the Special Trial Judge's opportunity to evaluate the credibility of witnesses if the Courts of Appeals are prevented from ever seeing those findings of fact. (And, as described above, regardless of Rule 183(c), the clear error standard, too, cannot be applied by the Courts of Appeals without examination of the Special Trial Judge's Report.)

Despite Rule 183(c)'s requirements of "due regard" and presumption of correctness, the Seventh Circuit recently held the Rule does not "prescribe any particular level of

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The Tax Court's refusal to permit the court below to examine the Special Trial Judge's Report also violates 26 U.S.C. §7482. The Courts of Appeals are required by 26 U.S.C. §7482 to "review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." By rendering impossible review of its findings of fact for clear error, and by further rendering impossible review of its decision for compliance with Tax Court Rule 183, the Tax Court's refusal to permit the Courts of Appeals to examine the Special Trial Judge's report violates this statute.

deference due the [Special Trial Judge's] report," *Kanter*, 337 F. 3d 841. This squarely conflicts with the D.C. Circuit which held in *Stone* that this provision imposes upon the Tax Court Judge the duty to review the Special Trial Judge's findings of fact under a clearly erroneous standard of review. See *Stone*, 865 F. 2d at 347. The D.C. Circuit adheres to that construction. See, *e.g.*, *Landry v. Federal Deposit Insurance Corp.*, 204 F.3d 1125, 1133 (D.C. Cir. 2000).

Indeed, the Seventh Circuit actually held that the Tax Court may, without hearing the witnesses, overrule under a *de novo* standard of review the credibility findings of the judge who heard the case. This not only conflicts with the D.C. Circuit opinion in *Stone*, it raises grave, independent constitutional concerns. Cf. *United States v. Raddatz*, 447 U.S. 667, 681 n. 7 (1980).

Because the resolution of this case requires a definitive construction of Rule 183(c), it squarely implicates the split in authority among the Circuits. It therefore presents an appropriate vehicle – and indeed, given the overlay of the extraordinarily important due process question it involves, it presents an ideal vehicle – for this Court to address that split.

3. The Preparation of an "Opinion" Through *ex Parte* Discussions Between the Special Trial Judge and His or Her Legally Mandated Reviewing Judge Violates Due Process.

Finally, it is not only the truncation of appellate review that violates federal law in this case. The Tax Court procedures employed below, defended by the Commissioner and described by Judge Cudahy in *Kanter* independently render the proceedings before that tribunal violative of Due Process.

As the Tax Court Rules make clear, while Special Trial Judges can not decide cases in the class of this one, 26 U.S.C. §7443A, they act as fact finders required to submit "findings of fact." Rule 183(b). The Tax Court Judges to whom these cases are assigned are required to act as reviewing judges. See Rule 183(c). The premise of the dictum in the opinion below thus is plainly wrong. This is not a case where "more than one judge is charged with responsibility for deciding the case." Pet. App. 9a. This is a case where the responsibility for making a finding is committed by law to one judge, and the responsibility for reviewing it is committed by law to another.

Any process by which the finder of fact participates in private in the deliberations of a reviewing court amounts to an *ex parte* proceeding which violates Due Process. "Before one may be deprived of a protected interest, whether in a criminal or civil setting, one is entitled as a matter of due process of law to an adjudicator who is not in a situation 'which would offer a possible temptation to the average man as a judge . . . which might lead him not to hold the balance nice, clear and true . . . .'" *Concrete Pipe*, 508 U.S. at 617-618 (citations omitted).

The presence within the deliberative chambers of a reviewing judge of the judge who rendered the decision under review clearly violates this bedrock principle. This would be no different than this Court conferring with a district judge whose opinion was under review. The Tax Court, after all, as this Court has explained with extraordinary clarity, is a court, not an administrative agency. See *Freytag v. Commissioner*, 501 U.S. 868, 891 (1991) ("The Tax Court exercises judicial power to the exclusion of any other function. . . . [Its] function and role in the federal judicial scheme closely resemble those of the federal district courts."). And this amounts to the

quintessential *ex parte* contact, a definitional violation of Due Process.[4]

Every Member of this Court should immediately see the extraordinary and improper nature of the Tax Court procedures that have come to light in this case, and the urgent need for this Court to act immediately to address them.

CONCLUSION

The petition for certiorari should be granted and the case set for oral argument, or it should be granted, and the case below vacated and remanded for reconsideration in light of the facts about the Tax Court procedure made clear in the Seventh Circuit proceedings in *Kanter* and the government's clear acknowledgement there that the procedures of the Tax Court it defends are indeed as described herein.[5]

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[4] Nor can there be any doubt that the Special Trial Judge has performed an "adjudication" of the questions of fact determined in its findings and reviewed by the Tax Court. The Supreme Court has defined for purposes of due process the hallmarks of one who performs an adjudication and the Special Trial Judge has them all. See *Concrete Pipe*, 508 U.S. at 619. He or she is "a judge." *Id.* (internal quotation marks and citations omitted). He or she performs "judicial or quasi-judicial functions." *Id.* (internal quotation marks and citations omitted). He or she "hold[s] . . . hearing[s]." *Id.* And he or she hears "witnesses and rules on . . . disputed factual or legal questions." *Id.* (internal quotation marks and citations omitted).

[5] See, *e.g.*, *Lawrence v. Chater*, 516 U.S. 163, 167 (1996) ("Where intervening developments, or recent developments that we have reason to believe the court below did not fully consider, reveal a reasonable probability that the decision below rests upon a premise that the lower court would reject if given the opportunity for further consideration, and where it appears that such a redetermination may determine the ultimate outcome of the litigation, a GVR order is, we believe, potentially appropriate.").

Respectfully submitted,

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October 6, 2003

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IN THE

Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ESTATE OF BURTON W. KANTER, ET AL.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
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On Writ of Certiorari to the United States Court of Appeals for the Seventh and Eleventh Circuits

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IN THE UNITED STATE COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

01-172949-GG

CLAUDE M. BALLARD,

v.

C.I.R.

DOCKET ENTRIES

File Date	Entry	Party
01/24/2002	Motion to Stay Proceedings: Appellant-Ballard, Claude M. (Atty: Steven Spencer Brown)	Claude M. Ballard
01/31/2002	Response in Opposition to Motion to Stay Appeals	
02/01/2002	Reply in Support of Motion to Stay	
03/27/2002	Appellant's Brief Filed: Appellant-Ballard, Claude M. (Atty: Robert Edwin Davis): Appellant-Ballard, Mary B. (Atty: Robert Edwin Davis)	Mary B. Ballard
05/06/20[illegible]	Appellee Brief Filed: Appellee-Commissioner of Internal Revenue, (Atty: Joan I. Openheimer)	
05/30/2002	Reply Brief Filed: Appellant-Ballard, Claude M. (Atty: Robert Edwin Davis): Appellant-Ballard, Claude M. (Atty: Robert Edwin Davis): Appellant-Ballard, Mary B. (Atty: Robert Edwin Davis)	

07/29/2002	Appellant's Unopposed Motion for additional time for oral argument is hereby GRANTED..in part. Each side shall have (20) Twenty minutes for oral argument..: (Atty: Vester T. Hughes, Jr.)	
02/13/2003	OPIN1A (Opinion - Issuance with Costs) issued. costs taxed against petitioners-appellants. cc: Brown, Steven Spencer cc: Hughes, Vester T., Jr. cc: Davis, Robert Edwin cc: Schenck, David J. cc: Martin, Royal B., Jr. cc: Openheimer, Joan I. cc: Gibson, J+	
02/13/2003	Judgment Entered	
03/28/2003	Petition for Rehearing En Banc: Ballard, Claude M., Ballard, Mary B. (Atty: Robert Edwin Davis):	Claude M. Ballard
05/22/2003	The motion of Appellants, for STAY of the issuance of the mandate pending petition for writ of certiorari is GRANTED to and including 8/4/03...PTF/See file for Complete Text	

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

ESTATE OF BURTON W. KANTER,
Plaintiff/Petitioner,
v.

C.I.R.,
Defendant.

DOCKET ENTRIES

DATE	ENTRY
12/26/01	Tax court case docketed. [01-4316] [1465040-1] Appellant's brief due 2/5/02 for Estate Burton Kanter. Docketing Statement due 1/3/02. (land) [01-4316]
9/4/02	Case heard and taken under advisement by panel: Chief Judge Joel M. Flaum, Circuit Judge Richard D. Cudahy, Circuit Judge Michael S. Kanne. [01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220] [1544207-1] (broo) [01-4316 01-4317 01-4318 01-4319 01-4320 01-4321 01-4322 02-1220]
7/24/03	Filed opinion of the court PER CURIAM. We AFFIRM in part and REVERSE in part the decision of the Tax Court. Chief Judge Joel M. Flaum, Circuit Judge Richard D. Cudahy, concurring in part and dissenting in part, Circuit Judge Michael S. Kanne. [01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220] [1465052-1] (amyd) [01-4316 01-4317 01-4318 01-4319 01-4320 01-4321 01-4322 02-1220]

DATE	ENTRY
7/24/03	ORDER: Final judgment filed per opinion. Petitioners-appellants to pay costs. [01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220] [0-0] (amyd) [01-4316 01-4317 01-4318 01-4319 01-4320 01-4321 01-4322 02-1220]
9/8/03	Filed 30c Petition for Rehearing and Petition for Rehearing Enbanc by Appellant Estate Burton Kanter in 01-4316, Appellant Estate Burton Kanter in 01-4317, Appellant Estate Burton Kanter in 01-4318, Appellant Estate Burton Kanter in 01-4319, Appellant Estate Burton Kanter in 01-4320, Appellant Estate Burton Kanter in 01-4321, Appellant Estate Burton Kanter in 01-4322, Appellant Naomi R. Kanter in 02-1220. Dist. [01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220] [1658913-1] (tiff) [01-4316 01-4317 01-4318 01-4319 01-4320 01-4321 01-4322 02-1220]
10/21/03	ORDER: Appellant Estate Burton Kanter in 01-4316, Appellant Estate Burton Kanter in 01-4317, Appellant Estate Burton Kanter in 01-4318, Appellant Estate Burton Kanter in 01-4319, Appellant Naomi R. Kanter in 01-4320, Appellant Estate Burton Kanter in 01-4320, Appellant Estate Burton Kanter in 01-4321, Appellant Estate Burton Kanter in 01-4322, Appellant Naomi R. Kanter in 02-1220 Petition for Rehearing and Petition for Rehearing Enbanc is DENIED. [01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220] [1658913-1] (tiff) [01-4316 01-4317 01-4318 01-4319 01-4320 01-4321 01-4322 02-1220]

DATE	ENTRY
10/29/03	MANDATE ISSUED AND ENTIRE RECORD RETURNED WITH BILL OF COSTS IN THE AMOUNT OF $114.40. (Contents returned: 44 vol. pleadings; 3 exhibits.) [01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220] [1597404-1] (amyd) [01-4316 01-4317 01-4318 01-4319 01-4320 01-4321 01-4322 02-1220]
4/26/04	Filed order from the Supreme Court GRANTING the Petition for Writ of Certiorari. Supreme Court Case No.: 03-1034. [01-4316, 01-4317, 01-4318, 01-4319, 01-4320, 01-4321, 01-4322, 02-1220] [1756190-1] (jame) [01-4316 01-4317 01-4318 01-4319 01-4320 01-4321 01-4322 02-1220]

UNITED STATES TAX COURT

CLAUDE M. BALLARD AND BURTON W. KANTER,

v.

C.I.R.,

Consolidated Docket Nos.
43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93, & 25981-93

DOCKET ENTRIES

DATE	EVENT	FILINGS AND PROCEEDINGS
01/09/86	PF	PETITION Filed: Fee Paid
07/14/87	OAJ	ORDER that case is assigned to Judge Williams.
07/18/90	ORJ	ORDER that case is reassigned to Judge Halpern.
01/07/94	ORJ	ORDER that case is reassigned to Judge Covillion.
01/14/94	O	ORDER set 6/13/94 Chicago, IL (Spec.) for trial. All mots. by any party to be filed by 5/23/94.

DATE	EVENT	FILINGS AND PROCEEDINGS
06/13/94	PTRL	PARTIAL TRIAL before S.T. Judge Couvillion at Chicago, IL Also called 6/14, 15, 16, 17, 20, 21, 22, 23 & 24. Resp's amendment to answer filed & served 6/13/94 (see below). Petrs' reply to amendment to answer filed & served 6/13/94 see below). Declaration by third party Solomon Weisgal filed 6/13/94 (see below). Resp's 5 mots. to compel compliance with subpoenas filed 6/20/94—Dn. (see below). Continued for further trial—SEE ORDER. NO BRIEFS DUE.
07/25/94	FTRL	FURTHER TRIAL before S.T. Judge Couvillion at Chicago, IL
02/14/95	O	ORDER record is closed.
05/15/95	BFR	BRIEF for resp. (Leave Gr.)
05/15/95	BFP	BRIEF for petr. (Leave Gr.)
12/15/99	ORJ	ORDER that case is reassigned to Judge Dawson.
12/15/99	MOP5	MEMORANDUM OPINION, Judge Dawson T.C. Memo 1999-407 (adopting opinion of S.T. Judge Couvillion). (Decisions in all dockets will be entered under Rule 155.)
01/24/00	O	ORDER mot. to ext. time is gr. in that time ext. to 5/15/00 for all parties to file any mot. for recons. & supporting memo. (Special instructions including limit on no. of pages in mot. & memo.) Parties by 3/15/00 file memorandum report.

DATE	EVENT	FILINGS AND PROCEEDINGS
04/20/00	MOTP	MOTION by petr. for access to original special trial judge report prepared under Rule 183(b), including request for interlocutory appeal & request that materials be made part of the record. (C/S 4/19/00) (Leave Gr.)
04/20/00	MEMO	MEMORANDUM OF POINTS & AUTHORITIES by Petrs. in support of mot. for access to original special trial judge report, etc. (C/S 4/19/00) (Leave Gr.)
04/26/00	O	ORDER Petrs' mot. for access to original special trial judge report, including request for interlocutory appeal & request that materials be made part of the record, is dn.
05/03/00	MOTP	MOTION by petr. for ext. of time to file mot. for recons. of opinion. (C/S 4/27/00)
05/04/00	O	ORDER Petrs' mot. to ext. time to file mot. for recons. is gr. in that time ext. to 6/2/00.
05/23/00	MOTP	MOTION by petr. to ext. time to 7/3/00 to file mot. for recons. (C/S 5/22/00)
05/26/00	MOTP	MOTION by petr. to place original special trial judge report under seal & made part of record for review by circuit court of appeals. (C/S 5/25/00) (per Judge)
07/31/00	MEMO	MEMO MEMORANDUM OF POINTS & AUTHORITIES by Petr. Kanter in support of mot. to reopen record & for recons. (per Judge)

DATE	EVENT	FILINGS AND PROCEEDINGS
08/22/00	MOTP	MOTION by petr. to reconsider Court's denial of Petrs' mot. for access to original special trial judge report prepared under Rule 183(b) or, in the alternative, for new trial. w/Ex. (C/S 8/21/00) (per Judge)
08/30/00	O	ORDER Petrs' mot. to reconsider Court's denial of Petrs' mot. for access to original special trial judge report or for new trial is dn.
12/05/00	MOTP	MOTION by petr. to stay entry of decision until ruling on Petrs' ORD 12/21/00 petition for writ of mandamus in Court of Appeals. (C/S 12/4/00)
12/21/00	O	ORDER Petrs' mot. to stay entry of dec. is dn. w/Exs. att'd
09/24/01	DEC	DECISION ENTERED, Judge Dawson
12/14/01	NOAP	U.S.C.A., 7th Cir. C/S 12-13-01. FEE PAID. (petr. Estate of Burton W. Kanter, Dec'd., Joshua S. Kanter, Executor) C.A.#01-4316.
12/26/01	NOAP	NOTICE OF APPEAL by petr. To U.S.C.A., 11th Cir. FEE PAID. C.A.#01-17251-I

U.S. TAX COURT

DOCKET NUMBER: 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93, 25981-93

In The Matter of:

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, *et al.*,

Petitioners,

vs.

COMMISSIONER OF THE INTERNAL REVENUE,

Respondent.

Volume I

Pages: 1-260

Location: Chicago, Illinois

Date: June 13, 1994

On The Record Reporting, Inc.
5926 Balcones Drive, Suite 115
Austin, Texas 78731
(521) 450-0342

[420] Q That is the—the bank where the check was ultimately cashed imprints that number on there. Now, on -37 there is no such number on the lower right-hand corner. Do you see that?

A Yes.

Q So it means that the copy of this check was made before the check was negotiated, since there is no bank number in the lower right-hand corner. Do you know why it is that one of the checks that you sent to the government was a check that came after negotiation and one was a check that was photocopied by you before negotiation?

A I would have no idea.

Q You have no idea? I would imagine this must have been done by somebody in your office?

A Don't know. Have no idea.

Q Now, Mr. Schaffel, to your knowledge, did Robert Lisle or Claude Ballard ever use any influence to obtain business for you, any persons or entities with which you were in business, at either Prudential Insurance Company or Travelers Insurance?

A No.

Q Did you ever intend to compensate either Claude Ballard or Robert Lisle for any business that you or any entity or persons with whom you were in business at either Prudential Insurance Company or Travelers?

A Never.

Q And do you have any knowledge of any payments to either Mr. Ballard or Mr. Lisle by virtue of any business that you or any person or entity with whom you were in business at Prudential Insurance Company or Travelers Insurance?

A No.

MR. MARTIN: I have nothing further.

THE COURT: Mr. Dick?

MR. DICK: I just have one brief question.

CROSS-EXAMINATION

BY MR. DICK:

Q. Now, you discussed the One River Associates and I think you testified that that was not a Prudential or a Travelers deal. Is that correct?

A Yes.

Q Okay. And that was from a savings bank name of?

A The financing was created by the Howard Savings Bank as a joint venture.

Q So neither—

A And the lender was New York Life.

Q Okay. And neither Prudential Nor Travelers had any relationship with these.

* * * *

examine? Mr. Martin?

CROSS-EXAMINATION

BY MR. MARTIN:

Q Mr. Frey, is it true that Mr. Kanter introduced You to Mr. Ballard for the purpose of causing Mr. Ballard -- for the purpose of influencing Mr. Ballard to do business with you?

A I don't recall that.

Q To your knowledge—

A I would say no.

Q To your knowledge, did Mr. Ballard ever use any influence to obtain business for you at the Prudential Insurance Company?

A Absolutely not. The business we got was on the merits.

Q Did you ever intend to compensate Mr. Ballard for any business that you did with Prudential?

A Absolutely not.

Q And do you have any knowledge of any -. compensation received by Mr. Ballard by virtue of business that you or your entities did with Prudential?

A Absolutely not.

MR. MARTIN: That is all I have got.

CROSS-EXAMINATION

BY MR. BROWN:

Q I will ask you similar questions for Mr. Lisle. To your knowledge, did Robert Lisle ever use any influence to obtain—

MR. DECATOR: Objection, Your Honor. This is beyond direct. We never even discussed Mr. Lisle in any way.

THE COURT: Well, the witness is on cross-examination. However, I do agree with you. I don't think Mr. Lisle's name was ever brought up on direct. But I think you could ask him whether or not he had any contact or knew Mr. Lisle.

BY MR. BROWN:

Q Have you ever met Mr. Robert Lisle?

A I don't believe so. He—after he left Prudential, he was at Travelers, and we went to Travelers one day. I don't think I am not sure we met him or not. we do.

Q Well, then, I will ask you the question. To your knowledge, did Robert Lisle ever use any influence to obtain business for you, any persons or entities with whom you were in business, either at Prudential or at Travelers?

A Absolutely not.

Q Did you ever intend to compensate Mr. Lisle, Mr. Robert Lisle, for any business that you or any entity or

persons with whom you were in business at either Prudential Insurance Company or Travelers Insurance Company—

A Absolutely not.

Q Do you have any knowledge of any payments to either—to Mr. Robert Lisle by virtue of any business that you or any person or entity with whom you were in business at either Prudential Insurance Company or Travelers Insurance Company?

A Absolutely not.

MR. BROWN: No more questions.

THE COURT: Mr. Dick?

MR. DICK: Yes, Your Honor. Just one minute.
(Pause.)

CROSS-EXAMINATION

BY MR. DICK:

Q I am going to hand you what has been entered into evidence as Exhibit 458 and direct your attention to page 2 of that document.

A Yes.

Q And I know this is hard to read, but in paragraph 6, it says, "The contribution of each limited partner is as follows." Do you see that?

* * * *

SCHNITZER - CROSS [2188]

But if I was to tell you that if Mr. Ballard or Mr. Lisle had ever been asked to intervene, that would have been the quickest way f o r us to have lost the regional business.

It is not—they could never help you. They could hurt you. And I am sure that if they didn't—wouldn't have wanted us to have the business, we couldn't have had it. But they sure as hell couldn't have gotten it for us and allowed us to keep it.

Q Now, who on the PMS side would do the negotiating with these regional people from insurance companies and other people?

A Most of the time it was done at a very senior level, but originally a man by the name of Burrows—Roland Burrows; following that, a man by the name of Joe Hudec, who was president. But they always worked with our regional person involved in that particular territory. So it was—but it required a very senior person to be dealing with that kind of—

Q So Mr. Hudec or Mr. Burrows, during the '70s, would have been doing this negotiation.

A Yes, sir.

Q And PMS did a good job, and that is why they are continuing to get business.

A Correct.

* * * *

SCHNITZER - CROSS [2192]

Q And you have had—oh, gosh—two or more conversations with them in preparation for this morning?

A Yes, sir.

Q Did they ever ask you during any of those interviews whether or not you ever made a payoff or bribe of any kind to Mr. Lisle or Mr. Ballard?

A I don't think they asked that. They asked me if I knew that—

Q Did they ask you whether or not you had ever paid them for any influence at Prudential or Travelers?

A I don't recall, to be honest with you.

Q To your knowledge, did Mr. Lisle or Mr. Ballard ever use any influence to obtain business for you either—or any persons with whom you were in business at either Prudential Insurance Company or Travelers Insurance Company?

A No, sir.

Q Did you ever intend to compensate these—either Mr. Ballard or Mr. Lisle for any business that you or any entity or

persons with whom you were in business at either Prudential Insurance Company or Travelers Insurance Company?

A No, sir.

Q Do you have any knowledge of any payments to either Mr. Ballard or Mr. Lisle by virtue of any business

* * * *

[2216]

of things. And apparently that—apparently you have not been advised of those kind of things.

MR. DICK: No, Your Honor.

MR. COMEAU: Judge—

MR. DICK: All we did is receive 4,000 checks from the Respondent. And Respondent's position has always been, Well, we have them; they are somehow relevant; stipulate to them. And we have consistently said, No, we are not. Tell us what is important in each check, why you would like it, and then we will discuss it.

And we have also said, Judge, if it relates to IRA, TMT, BWK, Carlco, or Mr. Schaffel or any of these entities, obviously they are relevant. The rest are not relevant.

THE COURT: But volume-wise, how much are we looking at?

MR. DICK: 2,000 pieces of paper.

THE COURT: 2,000 pieces of paper?

MR. DICK: At least—which I had to look for the ones before.

MR. BROWN: Some of which are made out to Xerox Company and—

THE COURT: It strikes the Court that somehow or another Respondent is attempting to throw the audit process into the

Court's hands, and the Court is not [2217] willing to do an audit.

MR. COMEAU: We are not willing to—

THE COURT: As Respondent well knows, we don't do audits.

MR. COMEAU: We are not willing—we are not suggesting that.

THE COURT: Well, when you start talking about 2,000 exhibits—

MR. COMEAU: When we have ten years, Judge.

THE COURT:—besides what—besides everything else that has been presented to the Court, I don't know.

MR. COMEAU: Well, if the problem—if the method of proof the Government is using to show the money flowing through would be a source-and-application-of-funds method of proof, or if this was a bank deposit case, where you are trying to prove admitted income through a bank deposit case, all deposits to that account or checks withdrawn from those accounts, even if they may be checks to Commonwealth Edison for a utility bill, would be documents that would be relevant in this case.

THE COURT: That is correct, but that is a different matter together. When you are applying an indirect method of income, that is because when Respondent determines that the books and records are not adequate to [2218] determine the taxpayer's income.

MR. COMEAU: Right.

THE COURT: But this is a totally different matter. I don't think Respondent has ever claimed that there were no books and records kept from which income could be determined.

MR. COMEAU: No, we are not. But—

THE COURT: You are claiming fraud.

MR. COMEAU: We are claiming the monies went directly Right.

THE COURT: And you are claiming fraud, and when you start saying—when you start dumping 2,000 documents and saying, All right, the fraud is all in this—

MR. COMEAU: No. But my point is, to adequately trace the money through the various bank accounts, you need the deposits and the withdrawals. Now, if we just had—they said IFI is not a Petitioner in this case. Well, there are non-related Petitioners: IFI—

THE COURT: Well, I understand that—that were corporations of Mr. Kanter. I understand that. I don't have any problem with that, if money has flowed through IFI and whatever else—IFC and whatever.

MR. COMEAU: The Holding Company, a number of

* * * *

[2220]

MR. COMEAU:—because there is no witness that may have said there is a conspiracy, but the money will show it.

MR. BROWN: Here we go. Okay. NOW, what does a check to American Express or a check to Amoco [phonetic] have to do with this case? That is what the counsel—

THE COURT: That is my concern.

MR. BROWN: Exactly.

MR. COMEAU: Well, we will take the checks—

THE COURT: If you can come up with specific—checks for—on which you are basing your case that those matters definitely will be introduced into evidence. But I am

concerned over a conglomeration of checks, and I led to believe that that is what we are looking at here.

MR. DICK: It is.

MR. BROWN: Yes, Your Honor.

MR. DICK: And that is only for one year. 2,000 checks for one year, and we have ten years here. We are talking about 20,000 checks.

THE COURT: If there was fraud involved—and I am not saying that there was or there wasn't—I haven't heard all the evidence. But it seems to me that unrelated checks certainly would not help your case at all. If anything, they probably hurt your case, really.

To be honest, if you want to establish fraud, you better specify and come down to specifics and don't throw a bunch of documents at me, because then—you know, I am human, too, and I will certainly give a lot more attention to something if you can come up with specific transactions and trace it through.

Just because it is IFI, and even though IFI is not a litigant in this case, that is not what I am looking at. But 2,000 exhibits on a lot of checks that admittedly are unrelated to his and are even unrelated to any kind of fraud—payments to Amaco or whatever—unless you can show that a payment to Amaco was for the benefit of Mr. Kanter individually or whatever—I don't know.

But at this point, I think the objection is well taken to those exhibits.

MR. COMEAU: Okay. Then, at this point—

THE COURT: You know, you have got plenty of time left, you know, to put these documents in order.

MR. COMEAU: Okay. Then with that I lost this argument—you are right. I understand. I have an argument why I want them in. You have ruled.

THE COURT: That is correct.

MR. COMEAU: With this ruling in mind and the predicament that it now places me in at this stage of the trial, with no records that we—of the ones we do need in, instead of sitting here for the rest of the afternoon,

* * * *

[2332]

both sides have very strong feelings about their cases, but you have got to understand that the Court is a third party in this.

MR. DICK: I agree.

THE COURT: And the Court, you know, has rules to go by.

And I don't think either side is being fair to their clients. I am not—you know, maybe I am being critical and maybe I shouldn't be, but, you know—

MR. DICK: Well, I think you are being critical and you should be, Judge.

THE COURT:—the cases are not being presented in a fashion that lawyers who are skilled and schooled in tax law should know about. And I don't know who is really to blame for all that. But all I can say is both sides seem to me have blocked off any communications with each other.

And here we are drifting along, and I don't know where the hammer is going to fall, but it is going to fall at a certain point in time, and somebody will not have presented their case.

MR. DICK: Well, it certainly will not be the Petitioners, Your Honor.

THE COURT: Well, it may be.

MR. DICK: We are ready to go, Judge. We really are.

* * * *

CONNOLLY - CROSS [2669]

that came to you as Gateway was a result of the management fee that you earned under the contract with Prudential.

A That is correct.

Q And you gave a part of that management fee away to, in essence, MHM and other partners in Essex to get you all the support services that you must have had in order to keep the contract with Hilton—

A That is correct.

Q —with Prudential. Excuse me. And the reason for the participation of John Formby in Essex and the reason for your relationship with Formby was because of his position with MHM. Right?

A That is correct.

Q He was the in-house financial person for MHM. Right?

A That is correct.

Q And he then became your financial person for Gateway.

A That is correct.

Q And that is because of this Essex partnership. Right?

A That is correct.

Q. Through the payments that Gateway, your company made to Essex, the partnership, the 80 percent of the management—75 percent of the management fee

[2670] CONNOLLY - CROSS

according to the contract—through those payments did you ever intend to compensate Claude Ballard or Bob Lisle for exercising their influence to get you any management contract?

A Absolutely not.

Q To your knowledge, did either Claude Ballard or Bob Lisle have anything to do with your obtaining those two hotel contracts?

A No.

Q And in fact, isn't it true that at the time that you obtained the Midland Hotel contract, Claude Ballard was already gone from The Prudential?

A That is correct.

MR. MARTIN: I have nothing further.

THE COURT: Mr. Dick?

MR. DICK: No, Your Honor.

THE COURT: No further cross-examination.

Any redirect, Ms. Gibson?

MS. GIBSON: One moment, Your Honor. We have no further redirect.

THE COURT: All right. I believe that would conclude your testimony, Mr. Connolly.

THE WITNESS: Thank you, Your Honor.

THE COURT: Thank you.
(Whereupon, the witness was excused.)

* * * *

we put on rebuttal that this evidence is being introduced with respect to the Prudential schemes and any of the non-Prudential issues and amended answers have been stricken.

THE COURT: Oh, I see what you mean. Right. I have already stricken that. That is correct.

MR. DICK: So this has to do with the Prudential.

THE COURT: But I think Respondent would bear the burden on that too.

MR. DICK: I agree.

THE COURT: So your burden would be to show that this income is not related—is related to the Prudential five, or to the Prudential scheme, or "The Five." I might learn all this after a while.

MR. MARKLEY: We know what you mean, we understand.

THE COURT: Are we understood here?

MR. MARKLEY: We understand, yes.

THE COURT: So I will allow the documents if that what those documents purport to show.

MR. MARKLEY: That is what we would represent that they purport to show.

THE COURT: But I want you to understand the questions that Petitioners are raising. Just because you put the check in the record does not necessarily establish

your proof; it may or it may not.

MR. MARXLEY: I certainly have had a lot of trials where I put lots of evidence in and it didn't prove anything.

THE COURT: All I know is I am not the attorney, I haven't been working on this three, four, five or ten years that you all have been working on it, so please understand, just being hit cold I can't decipher among all the various entities and trusts and whatever.

MR. MARKLEY: Judge, we understand that when you throw notebooks down the stairs, the heaviest one to the bottom isn't necessarily the best. We understand that, and that is not what we are saying. We are saying we need to get it in to be

able to argue that something is worthwhile in there, and we understand that.

THE COURT: All right. I don't know whether this is an appropriate expression to make, but I believe Yogi Berra made the expression that you can observe a lot just by looking. So I want to be able to look so that I can observe and conclude what we have.

MR. MARKLEY: He also said, It is deja vu all over again.

THE COURT: I don't know that Yogi Berra did all these things, but he is getting a lot of credit for things that do make a lot of cornfield sense.

UNITED STATES TAX COURT

Certificate of Transcriber and Proofreader

CASE NAME: Investment Research Associates Inc., *et al.*

DOCKET NUMBER: 43966-85, *et al.*

We the undersigned, do hereby certify that the foregoing pages, numbers 5298 through 5411, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Judy Miller on August 17, 1994, before the United States Tax Court at its session in Chicago, Illinois, in accordance with the applicable provisions of the current verbatim reporting contract of the Court, and have verified the accuracy of the transcript against the verbal recording.

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No. 03-184

Supreme Court, U.S.
FILED
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IN THE

Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

---

BRIEF ON THE MERITS

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QUESTIONS PRESENTED

In this case, the trial was conducted by a "Special Trial Judge," an employee-at-will of the Tax Court who serves at the pleasure of its Chief Judge. The Special Trial Judge was required to create a report of factual and legal findings, but his Tax Court Rule 183 report has never been made available to the parties, the public, or the reviewing Article III courts. Instead, his superiors on the Tax Court either overruled his factual findings or persuaded him to change his mind, thus creating a factual finding of tax fraud and income tax deficiencies. This entire process took place off the record, and came to light only in subsequent conversations between two Tax Court Judges and counsel for another party.

The questions presented are:

1. Whether this secretive process is consistent with the Due Process Clause or the right to effective Article III review?

2. Whether this secretive process is consistent with 26 U.S.C. § 7482, which provides that Article III courts must review Tax Court decisions just as they would decisions of a U.S. district court?

RULE 14.1(b) STATEMENT

The following are the parties to the proceeding in the Court of Appeals for the Eleventh Circuit:

1. Claude M. Ballard
2. Mary B. Ballard
3. Commissioner of Internal Revenue, United States Department of the Treasury

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IN THE

Supreme Court of the United States

No. 03-184

CLAUDE M. BALLARD AND MARY B. BALLARD
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF ON THE MERITS

BRIEF FOR PETITIONERS

Claude M. and Mary B. Ballard respectfully request that this Court reverse the judgment and opinion of the United States Court of Appeals for the Eleventh Circuit, entered in the above-entitled proceeding on February 13, 2003, which affirmed the United States Tax Court.

OPINIONS BELOW

The opinion of the court of appeals is reported at 321 F.3d 1037 (CA11 2003) and is reprinted in the Appendix to the Petition for Writ of Certiorari. The opinion of the Tax Court is reported at *Investment Research Associates, Ltd. v. CIR*, 1999 Tax Ct. Memo LEXIS 463, 78 T.C.M. (CCH) 951 (1999), and is reprinted in relevant part in the Appendix to the Petition for Writ of Certiorari.

JURISDICTION

The court of appeals issued its judgment on February 13, 2003 and denied rehearing on May 5, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and 26 U.S.C. § 7482(a)(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Constitution, Article III, § 1:

The judicial Power of the United States, shall be vested in one supreme court, and in such inferior Courts as the Congress may from time to time ordain and establish.

U.S. Constitution, amend. V:

No person shall . . . be deprived of life, liberty, or property, without due process of law. . . .

26 U.S.C. § 7482(a)(1):

The United States Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . . .

Tax Court Rule 183:

Except in cases subject to the provisions of Rule 182 or as otherwise provided, the following procedure shall be observed in cases tried before a Special Trial Judge:

(a) Trial and Briefs: A Special Trial Judge shall conduct the trial of any such case assigned for such purpose. After such trial, the parties shall submit their briefs in accordance with the provisions of Rule 151. Unless otherwise directed, no further briefs shall be filed.

(b) Special Trial Judge's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the Special Trial Judge shall submit a report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a Judge or Division of the Court.

(c) Action on the Report: The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

STATEMENT OF THE CASE

The IRS alleged that Claude Ballard and Robert Lisle, former Prudential Life Insurance Co. of America ("Prudential") real estate executives, and their respective spouses committed fraud in various tax years by failing to report personal income. Pet. App. at 41a-42a. According to the IRS's theory, the income in question was jointly "earned" by the Ballards and the Lisles as part of a complex scheme involving their friend and tax attorney, the late Burton W. Kanter. Kanter was a well-known tax attorney, a part-time law professor at the University of Chicago, a businessman with widely varied interests, and a regular (and often successful) adversary of the IRS for many years.[1] Pet. App.

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[1] Indeed, the IRS has engaged in an extraordinary pursuit of Kanter. The IRS and the Tax Court have created the "Levenfeld/Kanter Project" to describe the continuing scrutiny of Kanter. The circumstances in this

at 45a-49a. Reduced to its essence, the IRS speculated that entities desiring to do business with Prudential had to pay for the privilege by bribing Ballard and Lisle through corporations set up and controlled by Kanter.

It was undisputed at trial that corporations controlled by the Kanter family received remuneration from, *inter alia*, five entities seeking to do business with Prudential. However, rather than being forwarded on to the Ballards and Lisles, these funds were instead duly reported by Kanter's corporations and remained in the corporations (with only certain minor business exceptions) as part of Kanter's lawful personal tax planning. In all events, the Ballards never received any income as a result of these payments.

The Five-Week Trial Before Special Trial Judge Couvillion

The consolidated trial of the Ballards and the other taxpayers took place over a five-week period in the summer of 1994. Pursuant to Tax Court Rule 183, the trial was conducted by a "Special Trial Judge" ("STJ") named Irwin Couvillion, who was the only judge to hear the testimony and observe the witnesses. Pet. App. at 33a. As an STJ, Couvillion has no fixed term of service and is instead an at-will employee of the Tax Court, serving at the pleasure of its Chief Judge. *See* 26 U.S.C. § 7443A(a) (providing for appointment of Special Trial Judges at discretion of Tax Court's Chief Judge). Judge Couvillion and the other STJs are paid 90% of the salary of a regular Tax Court Judge.

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particular case speak for themselves. For example, in addition to the highly irregular process employed before the Tax Court and discussed below, the Tax Court *sua sponte* attempted to impose additional penalties upon the Lisle Estate ***after*** the Fifth Circuit reversed the Tax Court's finding of fraud for lack of evidence. The Fifth Circuit rebuked this effort and issued an order warning the Tax Court against "mak[ing] yet another reversal necessary." *See* Appendix to this Brief.

The five-week trial over which Judge Couvillion presided involved testimony from some fifty-five witnesses and resulted in a transcript of over 6,000 pages in length. Because fraud was at issue, the assessment of the credibility of this lengthy parade of witnesses was central to the outcome of the case. Judge Couvillion was the only judicial officer present at the trial, and no rule or statute requires any other Tax Court Judge to review the trial transcript. All of the many witnesses called to testify about the five transactions in question swore they had not been required to pay for influence or assistance in obtaining Prudential's business.[2] Indeed, not a single witness testified that they had ever sought, received, or paid for Ballard's influence at Prudential.

Judge Couvillion expressed significant doubts concerning the Government's fraud case from the bench at trial, angrily noting at one point that "you are claiming fraud, and when you . . . start dumping 2,000 documents and saying, 'All right the fraud is all in this,'" before he was cut off by the IRS's lawyer.[3] Judge Couvillion later observed that "it seems to the Court that somehow or another [the IRS] is attempting to throw the audit process into the Court's hands, and the Court is not willing to do an audit."[4] The STJ admonished the IRS on the quality of its fraud case, warning that "[t]o be honest, if you want to establish fraud, you better specify and come down to specifics and don't throw a bunch of documents at me."[5] Judge Couvillion would later complain, "the cases are

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[2] Joint Appendix ("J.A.") at 11-24 (Tax Court Trial Transcript (hereinafter "Tr.") at 420-21, 713-15, 2188, 2192, 2669-70).

[3] J.A. at 17-18 (Tr. 2218).

[4] J.A. at 16-17 (Tr. 2216-17).

[5] J.A. at 18-19 (Tr. 2220-21). The judge later noted, "Just because you put the check in the record does not necessarily establish your proof; it may or it may not." The IRS counsel responded, "I certainly have had a lot of trials where I put lots of evidence in and it didn't prove anything." J.A. at 22-23 (Tr. 2973-74).

not being presented in a fashion that lawyers who are skilled . . . in tax law should know about . . . here we are drifting along and I don't know where the hammer is going to fall, but it is going to fall at a certain point . . ., and somebody will not have presented their case."[6]

The Original Findings of Fact

After concluding this long and evidently frustrating trial, Judge Couvillion prepared a report, pursuant to Tax Court Rule 183(b), containing his factual findings and recommended legal conclusions. While, as discussed below, Judge Couvillion's Rule 183 report itself is not part of the record, uncontradicted record evidence shows that this report included factual findings and credibility determinations supporting the Ballards' innocence. Pet. App. at 308a-09a. Further, the same uncontradicted record evidence indicates that Judge Couvillion's Rule 183 report found the Ballards and the other taxpayers ***not guilty*** of tax fraud or underreporting of income. *Id.* Judge Couvillion's Rule 183 report was then filed with the Tax Court on September 2, 1998, after which the Chief Judge of the Tax Court assigned the case to Tax Court Judge Howard A. Dawson, who eventually issued the opinion of the Tax Court. *Investment Research Assocs., Ltd. v. CIR*, 1999 Tax Ct. Memo LEXIS 463, 78 T.C.M. (CCH) 951 (1999) (Pet. App. at 19a). That opinion purports to be written by STJ Couvillion and "adopted" by Judge Dawson. Indeed, the language of the opinion suggests that it is identical to the Rule 183 report filed by Judge Couvillion; "The Court agrees with and adopts the opinion of the Special Trial Judge, ***which is set forth below***." Pet. App. at 33a (emphasis added). There is no indication in the Tax Court's opinion itself that any modifications or alterations were made to Judge Couvillion's Rule 183 report.

[6] J.A. at 20 (Tr. 2332).

The Opinion as Released

The Tax Court's final opinion, as released to the parties and the reviewing Article III courts, however, found the Ballards and the other taxpayers ***guilty*** of underreporting income and of tax fraud for the years in question, notwithstanding the uniform live testimony to the contrary and the lack of any actual receipt of the money by any of the taxpayers. J.A. at 7; Pet. App. at 265a-66a; 287a-89a; 294a-95a. Amazingly, despite its voluminous length, the Tax Court's opinion fails to explain why or on what basis the exculpatory testimony heard at trial was rejected. Instead, the opinion spends over two hundred pages ostensibly tracking the "flow of the money" and rarely even mentioning the testimony at trial—let alone explaining why it was not credited. Pet. App. at 19a-295a.

Critically, as the IRS apparently conceded at oral argument before the Eleventh and Seventh Circuits,[7] Judge Couvillion's original factual findings had been ***changed*** without any explanation and without any record being made of the changes. The IRS's evident concession at oral argument that these changes to Judge Couvillion's Rule 183 report did, in fact, occur confirms the substance of the uncontradicted record evidence introduced by the taxpayers. Pet. App. at 308a-09a. These unexplained and off-the-record changes were made at the direction of a regular Tax Court Judge, who was certainly not present at trial and who may or may not have reviewed the over-6,000 page transcript.

Thus, what purports on its face to be an opinion ***adopting*** Judge Couvillion's Rule 183 report, *see* Pet. App. at 33a, was

[7] An audio recording of the *Kanter* oral argument can be found on the Seventh Circuit's website at http://www.ca7.uscourts.gov/farg/arg.fwx?caseno=01-4316&submit=showdkt&yr=01&num=4316. The Eleventh Circuit does not release transcripts to the parties, but this Court would presumably be allowed access to those materials.

actually an opinion ***reversing*** the report. The reasons underlying Judge Couvillion's apparent acceptance of the changes to his Rule 183 report are not recorded anywhere and remain unknown.

The Tax Court's refusal to make a record of its reversal of Judge Couvillion's original fact-finding report stems from a unique and relatively recent change to Tax Court procedure embodied in Tax Court Rule 183. Prior to 1984, the record of the Tax Court's rejection or modification of an STJ's report was made known to both the parties and the reviewing courts. However, perhaps anticipating that Article III courts would soon require regular Tax Court Judges to conduct "clear error" review of the STJ's factual findings,[8] the Tax Court amended its rule so as to prevent the creation of any record of its rejection or modification of the STJ's report. In other words, the Tax Court modified Rule 183 so as to make it impossible for an appellate court to determine whether the STJ's factual findings were properly subjected to "clear error" or any similiar standard of review.

The Taxpayers Pursue Explanation of the Outcome and Article III Review

Frustrated by the unexplained and radical modification of Judge Couvillion's Rule 183 report, the Ballards and the other taxpayers filed a series of motions asking that the report be released or, in the alternative, that it be made part of the record (under seal if necessary) to permit appellate review.[9]

[8] Indeed, this is precisely what the D.C. Circuit held shortly thereafter in *Stone v. CIR*, 865 F.2d 342, 346-47 (CADC 1989), concluding that "the Tax Court should have reviewed the Special Trial Judge's factual findings according to a clearly erroneous standard."

[9] In seeking the Rule 183 report, the Ballards and the other taxpayers relied on an affidavit filed under penalty of perjury by Kanter's counsel, Randall Dick, in which Mr. Dick recounted conversations in which two Tax Court Judges revealed to him that Judge Couvillion's report had been reversed. *See* Dick Affidavit, Pet. App. at 308a-10a. Notably, the Tax Court *never* denied that Mr. Dick's affidavit was accurate, or that Judge Couvillion's factual findings had been reversed at some point before issuance of the Tax Court's opinion. Neither the Tax Court nor the IRS has challenged or contradicted Mr. Dick's affidavit. Nor has the Tax Court taken any action against Mr. Dick, who remains a member in good standing of the Tax Court Bar. Surely if Mr. Dick's affidavit was anything other than accurate, this would not be the case.

J.A. at 8-9. The Tax Court denied all these motions, and the report remains secret to this day—even from this Court.[10] J.A. at 8-9.

On July 24, 2001, Judge Dawson entered the final decisions of the Tax Court against the Ballards, who timely appealed to the Eleventh Circuit J.A. at 9. IRS counsel conceded at oral argument before the Eleventh Circuit that it had *no* evidence to support its original theory that Judge Couvillion had found fraud and tax deficiencies from the beginning. Instead, the IRS speculated—in a theory advanced for the first time at oral argument—that even if Judge Couvillion's Rule 183 report found no fraud or taxes due, he *later changed his mind* due to an off-the-record, *ex parte* "conference" with Judge Dawson (*i.e.*, one of his employers and a non-attendee of the trial). Thus, when the Tax Court purported to "adopt" Judge Couvillion's opinion, it was

[10] On August 30, 2000, the Tax Court issued an order signed by Special Trial Judge Couvillion, Judge Dawson, and the Chief Judge of the Tax Court denying the third and final motion. It merely restates:

> Judge Dawson states and Special Trial Judge Couvillion agrees, that, after a meticulous and time-consuming review of the complex record in these cases, Judge Dawson adopted the findings of fact and opinion of Special Trial Judge Couvillion, that Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and that Judge Dawson gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses.

T.C. Order of Aug. 30, 2000, Pet. App. at 315a. As discussed *infra*, the accuracy of this statement is in doubt.

technically correct in that Judge Couvillion had apparently by then come to disagree with his own original factual findings and credibility determinations, albeit for reasons that are not explained in the record or anywhere else.[11]

The Eleventh Circuit's decision was issued on February 13, 2003. *Ballard v. CIR*, 321 F.3d 1037 (CA11 2003) (Pet. App. at 1a). In its opinion, the Eleventh Circuit accepted the IRS's latest interpretation of this case's events, stating that "there is nothing unusual about judges conferring with one another about cases assigned to them," and that, "as a result of such conferences, judges ***sometimes change their original position or thoughts***." *Id.* at 1043 (emphasis added). "Whether Special Trial Judge Couvillion prepared drafts of his report or subsequently changed his opinion entirely is without import insofar as our analysis of the alleged due process violation pertaining to the application of Rule 183 is concerned." *Id.*

The Eleventh Circuit denied a petition for rehearing on May 5, 2003. J.A. at 2; Pet. App. at 307a.

The Ballards sought certiorari on the issue of whether the Tax Court's refusal to divulge Judge Couvillion's original fact-findings to either the parties or the reviewing Article III court constituted a denial of due process, a violation of Article III, or a violation of the statute guaranteeing court of appeals' review of Tax Court decisions. Certiorari was granted to review these questions.

Because appeals from Tax Court cases are taken to the circuit court of appeals in which the taxpayer resides, *see* 26 U.S.C. § 7482(b)(1)(A), the Kanter, Ballard, and Lisle appeals went to different circuit courts of appeals. The Fifth Circuit, which handled the appeal with respect to the Lisles, found the record evidence insufficient to support a finding of

[11] IRS counsel advanced the same novel "changed his mind" theory in oral argument before the Seventh Circuit.

tax fraud. *Estate of Robert W. Lisle v. CIR*, 341 F.3d 364 (CA5 2003). In other words, the Fifth Circuit concluded that regardless of what procedure the Tax Court followed to make its factual decision, that decision was in error because there was insufficient evidence of fraud. As such, the Fifth Circuit tersely and without analysis adopted the Eleventh Circuit's conclusion regarding the constitutionality of Tax Court Rule 183. However, although the Fifth Circuit attempted to avoid creating a direct circuit conflict by suggesting there are evidentiary distinctions between the Ballard and Lisle cases, *id.* at 385 n.39, its holding nonetheless unavoidably undermines the Tax Court's entire factual theory of the consolidated case, by which Ballard, Lisle, and Kanter supposedly all participated in a unified conspiracy to split certain moneys in a 45-45-10 ratio, *see* Pet. App. at 295a. Neither Lisle nor the IRS sought certiorari.

The Seventh Circuit handled attorney Kanter's appeal. On July 24, 2003, the Seventh Circuit issued its opinion in the companion case of *Estate of Kanter v. CIR*, 337 F.3d 833 (CA7 2003), *cert. granted*, __ U.S. __, 124 S. Ct. 2066 (2004); J.A. at 3. In that opinion, the court found no due process violation in the Tax Court's withholding of the Rule 183 report. A lengthy dissent by Judge Cudahy, however, argued that the Tax Court's unprecedented lack of transparency stripped the taxpayers of their right to effective appellate review and thus represented a violation of due process. *Kanter* at 874-88. Even though the Seventh Circuit conducted its review without the benefit of access to the Rule 183 report, it found the Tax Court's final opinion lacking in evidentiary support for one out of the six main factual issues. *Id.* at 854-57.

Following the denial of a petition for rehearing before the court of appeals, Kanter's Estate sought certiorari on similar grounds as the Ballards. J.A. at 4-5. Certiorari was granted, and the two cases are consolidated before this Court.

SUMMARY OF ARGUMENT

Under Tax Court Rule 183, this case was assigned to an STJ for trial. That judge alone heard live, sworn testimony from some fifty-five witnesses, yielding a transcript more than 6,000 pages in length. Contrary to the IRS's theory of the case, all of the witnesses with knowledge of the transactions, including the supposed victims of the alleged "kick back" scheme, flatly denied that anyone had been required to pay anything as a condition of seeking or obtaining business with Prudential. Indeed, during the trial, the STJ was openly critical of the IRS's theory of the case. More important, consistent with the live testimony he heard at trial, the STJ evidently issued a report finding no fraud on the part of any of the taxpayers.[12]

However, the opinion that was ultimately released by the Tax Court to both the parties and the reviewing Article III courts somehow comes to exactly the opposite conclusion—albeit without any explanation of why or how the changes to the secret fact-finding report were made. The Tax Court's opinion gives no hint that it contains anything other than the original, unaltered conclusions of the STJ as "adopted" by a regular Tax Court Judge.

In fact, this is simply not the case: the Tax Court's final opinion represents a complete and unexplained reversal of the STJ's original findings of fact. We know this only because several Tax Court Judges were so offended by the unorthodox "fact-finding" process used in this case that they revealed this off-the-record reversal to a lawyer who was, in turn, willing to make a record that neither the Tax Court nor the IRS has challenged. Pet. App. at 308a-09a.

Notwithstanding the fact that the Tax Court opinion, as released, consumes more than 600 pages, it does not attempt

[12] *See supra* at pp. 6-10.

to explain why the trial testimony of more than a dozen live witness was simply rejected. Nor, more importantly, does it explain ***why*** the factual determinations of the only trier of fact present at the trial and capable of making credibility determinations were rejected.

Despite acknowledging that the original fact-findings must, as a matter of law, be given substantial deference, the IRS and the Tax Court contend that neither the litigants nor the Article III courts—including this Court—are entitled to review the Tax Court's reasons for rejecting or modifying an STJ's original findings of fact. Denying the parties and reviewing Article III courts access to the trier of fact's original findings is without precedent in all of American jurisprudence. Stranger still, neither the Tax Court nor the IRS has identified a meaningful reason for this radical break from universally accepted judicial procedures and the strong public policy in favor of judicial transparency.

No matter which of the IRS's many and shifting explanations for what happened at the Tax Court the Government chooses to put forward before this Court, Tax Court Rule 183 runs afoul of: (1) the statute creating the Tax Court and mandating plenary Article III review, (2) the due process rights of taxpayers, and (3) Article III itself. Litigants facing massive financial liability and the opprobrium of a finding of fraud are entitled to know who decided the facts of their case. Further, if the original fact-findings made by the only judge present at trial are changed, the taxpayers are entitled to a record of those changes and an explanation of why they were made. Finally, consistent with the command of Congress, the taxpayers are entitled to meaningful Article III appellate review of the validity of the changes made to the original fact-findings, with that review conducted on a full record. In all events, by jealously guarding the secrecy of the STJ's original fact-findings, Tax Court Rule 183 deprives the

taxpayers of each of these critical procedural safeguards and thus violates due process.

Fortunately, this denial of due process and meaningful Article III review can be easily and inexpensively remedied, simply by ordering the Tax Court to provide the appellate courts and the parties with a copy of the STJ's Rule 183 report.

ARGUMENT

I. THE TAX COURT'S REFUSAL TO MAKE THE FACT-FINDING AVAILABLE EITHER TO THE PARTIES OR THE APPELLATE COURTS IS ABERRANT

Tax Court Rule 183 is aberrant. As explained in detail in this section, regardless of how it is construed or interpreted, Rule 183 establishes a procedure that is manifestly inconsistent with the procedural norm universally followed by American courts. Having revealed Rule 183's aberrant nature, the second section of the brief details how its needlessly secretive procedure violates due process.

A. The Tax Court's Right to Use Special Trial Judges to Conduct Trials and Make Findings of Fact as Authorized by Congress Is Not in Dispute.

The Tax Court is authorized by Congress to hire "Special Trial Judges" ("STJs") to help manage its docket. *See* 26 U.S.C. § 7443A(a)-(b). These STJs are employees-at-will who serve at the pleasure of the Chief Judge of the Tax Court. *Id.* Tax Court Rule 183, as amended in 1984, authorizes Special Trial Judges to "conduct the trial" in cases assigned to them. Tax Ct. R. 183(a). As the lone judicial officer presiding at trial, the STJ has the power to "take testimony, conduct trials, rule on the admissibility of evidence, and . . . enforce compliance with discovery orders." *Freytag v. CIR*,

501 U.S. 868, 881-82 (1991). At the conclusion of trial, the STJ receives the parties' briefs and prepares a report, "including findings of fact." Tax Ct. R. 183(b). That report is then reviewed by a regular Judge of the Tax Court who may accept it, modify it, or reject it in whole or in part. *Id.* at 183(c). The regular Judge of the Tax Court must grant deference to the STJ's findings of fact, as Rule 183 dictates that "[d]ue regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Because they are "presumed to be correct," the STJ's fact-findings necessarily enjoy a legal status independent of any regular Tax Court Judge's view of the facts. None of this is unusual or remarkable, and the Petitioners certainly do not challenge the Tax Court's right to use STJs.

The fact-finding function is quite often separated from the ultimate power to render judgment. This is, of course, the very purpose of the jury trial. Even more analogous, special masters, administrative law judges, bankruptcy judges in non-core cases, and magistrates routinely sit as fact-finders and likewise prepare written findings, subject to review under deferential standards. Indeed, that process has been reviewed and approved by this Court, but with certain critical qualifications—including deference to the judge hearing the live testimony and judicial transparency—apparently lost on the Tax Court. *See United States v. Raddatz*, 447 U.S. 667, 681 (1980); *Peretz v. United States*, 501 U.S. 923, 939 (1991).

B. Since 1984, the Tax Court Has Inexplicably Refused to Make a Record of the Special Trial Judge's Fact-findings, Before or After They Are Altered.

Since 1984, the Tax Court has embarked down a unique path by which a STJ's original findings of fact are not made part of the record either before or after they are "rejected or modified" by a regular Tax Court Judge who was not present at trial and who did not observe any of the witnesses. Even in this civil fraud trial, requiring clear and convincing evidence, the Tax Court has assumed the right to change the outcome and the credibility determinations without recalling or observing witnesses, without recording that any change was even made, and without making any record explanation of why a change was made.[13] Indeed, under this revised rule, the Tax Court has not acknowledged "modifying" or "rejecting" any report of any STJ in any of the more than 880 cases decided under new Rule 183. *Kanter*, 337 F.3d at 876 (Cudahy, J., dissenting) ("Never, in any instance since the adoption of the current Rule 183 that I could find has the Tax Court Judge *not* agreed with and adopted the STJ's opinion."). Quite the contrary, every one of those decisions, like the decision in this case, simply purports to agree with and "adopt" the STJ's decision. *Id.* As Judge Cudahy observed, this unprecedented record of purportedly perfect agreement over the course of twenty years between all regular Tax Court Judges and STJs reveals the aberrant nature of the Tax Court's procedures: "I say with confidence that this degree of unanimity is not only unusual, but impossible in a system of arms-length appellate-style review involving 39 independent individuals." *Id.* In other words, Rule 183

[13] Notably, however, the Fifth Circuit concluded that even the Tax Court's revised opinion failed to identify evidence sufficient to satisfy the clear and convincing standard for the taxpayer before it. *Lisle*, 341 F.3d at 384-85.

necessarily masks a process under which Tax Court opinions contain, without acknowledgement, findings that differ from those reached by the judge who tried the case.

This is unprecedented and, as discussed in greater detail *infra* in Section II, so contrary to established procedural norms as to raise a presumption that the rule violates due process. *Honda Motor Co., Ltd. v. Oberg*, 512 U.S. 415, 430 (1994). Separately, and as explained more fully below, the refusal to allow the litigants and reviewing courts access to the original fact-finding (or to so much as offer a rationale for not doing so) violates the traditional three-part due process test of *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976).

C. None of the Shifting Explanations of the Tax Court's Conduct Withstands Scrutiny.

As noted, the secretive treatment of the original fact-finder's conclusions is unique to the Tax Court. Prior to 1984, the Tax Court's rules called for the original findings to be made of record and to be available for appellate review, as is true in virtually every other adjudicative process. Indeed, in *Stone v. CIR*, 865 F.2d 342, 347 (CADC 1989), the D.C. Circuit confirmed that regular Tax Court Judges were obligated to apply "clear error" review to the STJ's factual findings.

However, the Tax Court was evidently uncomfortable with the courts of appeals reviewing its own review of the STJ's Rule 183 report, and it instead sought to avoid this prospect by simply withholding the STJ's report from reviewing Article III courts—something it did without purporting to alter the deference it was bound to give the findings in those reports. In other words, despite the fact that the STJ's Rule 183 report continues to enjoy the independent legal status inherent in being "presumptively correct," it is now kept secret from the parties and the appellate courts—including this Court. This, of course, prevents an appellate court from

determining what, if any, level of deference the Tax Court gave to the STJ's report. Indeed, the Tax Court changed Rule 183 to accomplish exactly this. Regardless of the Tax Court's motives or lack of explanation for the change in its rules, the current version of the Rule 183 indicates that the reviewing judge may "adopt it ***or*** may modify it or may reject it in whole or in part." Tax Ct. R. 183(c) (emphasis added).

This Court has long indicated that U.S. district judges cannot constitutionally reject credibility determinations without recalling and personally observing witnesses—much less do so without even indicating that such a change has been made. *See Raddatz*, 447 U.S. at 681 n.7; *Peretz*, 501 U.S. at 939.

Indeed, in every other context in which disputed fact issues affecting property and liberty interests are resolved, there is a record of the finding of fact and a deferential standard applied to any subsequent alteration of that finding ***on the record***. Even the Tax Court concedes in its own rule that the original fact-findings must, as a matter of law, be given substantial deference because the reviewing judge was not present. Tax Ct. R. 183(c). What the Tax Court refuses to accept is that its own application of the standard of review applicable to fact-findings may itself be subjected to judicial scrutiny in the Article III courts.

Stated directly, the Tax Court's refusal to disclose the original fact-findings denies the litigants due process, violates the statute that both creates the Tax Court and provides that its decisions be reviewed in the same manner as decisions of the U.S. district courts, and ultimately encroaches on this Court's and the courts of appeals' power under Article III to review the Tax Court's decision.

The Tax Court's opinion, as issued to the parties and shared with the Article III courts, states on its face that Judge Dawson has simply "adopted" the opinion of Special Trial

Judge Couvillion. Pet. App. at 332. Given the limited options available to Judge Dawson (specifically, to "adopt" or "to modify" or "to reject" the STJ's original factfindings), it is reasonable to conclude that he did not reject or modify the fact-findings ***at some earlier point in time***.

In fact, however, it is now undisputed that, notwithstanding the claim of "adoption" that appears on the face of the opinion, the Rule 183 report was ***both*** "rejected" and extensively "modified," albeit for reasons that remain unknown to the parties and to this Court.[14] In other words, the fact-findings that Judge Dawson "adopted" were not the same—indeed, were radically different—from those that Judge Couvillion originally provided. Further, because of the off-the-record nature of the "rejection" and "modification" of the Rule 183 report, it is impossible for any reviewing Article III court to determine if Judge Dawson did indeed give "due regard" to Judge Couvillion's "presumed to be correct" fact-findings.

The IRS's explanation of the relationship between the STJ and the regular Tax Court Judge under Rule 183 and how this case and others are decided has steadily shifted over the course of this case—and sometimes within even the same brief. First, the IRS initially portrayed the STJ as little more

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[14] It is unclear from the text of Rule 183 whether the regular Tax Court Judge may simultaneously exercise more than one of his options for dealing with the Special Trial Judge's report. The Tax Court's precedents are of no help in confronting this question because, to the best of both Petitioners' and Judge Cudahy's ability to discern, the Tax Court ***always*** purports to "adopt" the STJ's report. *See Kanter*, 337 F.3d at 876 (Cudahy, J., dissenting) (". . . in the 880-plus Tax Court decisions since 1983 that I could find that involved an STJ report, the Tax Court Judge purported to agree with and adopt the opinion of the STJ in *every* instance. Never, in any instance since the adoption of the current Rule 183 that I could find, has a Tax Court Judge *not* agreed with and adopted the STJ's opinion.").

than a proxy for the absent regular judge who sits as the actual, albeit remote, fact-finder.[15] In the alternative, the IRS has also attempted to characterize the STJ as a "peer" to the regular Tax Court Judge, and has explained that the two judges together make the factual findings in an off-the-record judicial conference during which the regular trial judge somehow assists the STJ in arriving at credibility determinations.[16] The Eleventh Circuit accepted this latter explanation, noting that "there is nothing unusual about judges conferring with one another about cases assigned to them." *Ballard*, 321 F.3d at 1042-43.

While neither Congress nor Rule 183 clearly defines the relationship between an STJ and a regular Tax Court Judge, there are only three possible ways to conceptualize this relationship in the fact-finding context—and only one of

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[15] *See* Brief for the Respondent in Opposition to Petition for Writ of Certiorari at 11, n.2 (". . . the Tax Court Rules now make it clear that review by a regular judge of a special trial judge's report is not an appellate review ***but is an exercise of the regular trial judge's original fact-finding authority***") (emphasis added); Appellee's Brief in the Eleventh Cir. at 75-76 ("As the statute itself makes plain, a special trial judge assigned to the case . . . ***is not the finder of fact***, and is instead only an aide to the chief judge and the regular judge of the Tax Court to whom authority and responsibility for the case are assigned. . . . the special trial judge only makes recommendations to the chief judge and the regular judge of the court as to what facts should be found.") (emphasis added).

[16] *See* Brief for the Respondent in Opposition to Petition for Writ of Certiorari at 15 ("Nor do the communications that occur among judges with collaborative responsibility represent prohibited ex parte communications. . . . This form of collaborative judicial process, whether in the Tax Court or in other courts in which a shared decisional process occurs, does not violate Due Process."); Appellee's Brief in the Eleventh Cir. at 92-93 ("It would be peculiar in the extreme if a special trial judge were forbidden to consult with the regular judge who, as a matter of law, must decide the case.").

these ways is plausibly consistent with the Tax Court's own rules, due process, and the Article III rights of the parties and this Court:

1. *The STJ is fact-finder*. The STJ hears the evidence and makes the initial factual determination, which is then subject to deferential review by a regular Tax Court Judge and ultimately by the Article III courts, in much the same way that a federal district judge reviews a magistrate's fact-findings. This is the process that the plain language of Rule 183 calls for and is consistent with the D.C. Circuit's holding in *Stone*, 865 F.2d at 347 (holding that regular Tax Court Judges must apply "clear error" review to the STJ's factual findings).

2. *The STJ is not the fact-finder*. Rather, the STJ merely presides at trial as a sort of proxy for the regular Tax Court Judge, taking notes and making observations on his behalf. Based upon some combination of the STJ's secret report and a review of the trial transcript, the regular Tax Court Judge, and not the STJ, actually makes the "original" fact-findings, despite not attending the trial. This is one of the constructions of Rule 183 that the IRS advocates.

3. *The STJ's Report is only an initial credibility proposal*. The STJ and the regular Tax Court Judge, who is absent from the trial, are "peers" who confidentially collaborate after the conclusion of trial to jointly make the credibility determinations. The two judges confer about the facts and credibility in confidence, in a manner analogous to two appellate judges sitting on the same panel and deciding difficult issues of law. This is the explanation of the STJ-Tax Court Judge interaction that the Eleventh Circuit ultimately accepted. *Ballard*, 321 F.3d at 1042-43.

Regardless of which explanation the IRS ultimately offers, the analysis is, in the final measure, unchanged: because of the Tax Court's refusal to reveal the original fact-findings, the taxpayer is denied due process, the strong policy in favor of judicial transparency is ignored, and meaningful Article III appellate review is thwarted. Specifically, by maintaining strict secrecy surrounding the STJ's fact-finding report, the Tax Court's procedure violates the following universally accepted procedural norms: (1) fact-finding must be made on the record, (2) credibility determination should rarely, if ever, be reversed by someone who was not present at trial, (3) none, including the judge, should have *ex parte* contact with the fact-finder prior to the announcement of the factual conclusions, and (4) meaningful judicial review of the decisions of an Article I court by an Article III court must be possible.

1. *It Is Impossible to Determine if the Tax Court Judge Gave Proper Deference to the STJ's Credibility Determinations, Thus Denying the Taxpayer Meaningful Article III Review.*

The most straight-forward reading of Tax Court Rule 183 is that the STJ makes fact-findings subject to appellate-style review by a regular Tax Court Judge. In reviewing the STJ's fact-findings, the regular Tax Court Judge is obligated to give "due regard" to the STJ's unique status as the only judge to have had "the opportunity to evaluate the credibility of the witnesses." Tax Ct. R. 183(c). Indeed, the plain language of the Rule 183 mandates that the STJ's fact-findings "shall be presumed to be correct." The D.C. Circuit has held that the reviewing Tax Court Judge is to apply the deferential "clear error" standard of review. *Stone*, 865 F.2d at 347. While the Eleventh Circuit disagreed and concluded that the reviewing Tax Court Judge does not need to apply the clear error standard to the STJ's fact-findings, in light of the express

language of Rule 183,[17] it is indisputable that ***some level*** of deference ("due regard") must be given to the STJ's report.

In short, under this reading, Rule 183 is, in part, consistent with the universal practice of American courts that credibility determinations made by the trier of fact, whether a judge or jury, are to be given great respect and are rarely, if ever, to be altered by a judge who was not present at trial. Indeed, save for the inexplicable secrecy with which the STJ's report is treated, this interpretation of Rule 183 yields a system closely analogous the federal district courts' use of magistrate judges.

Nonetheless, even this understanding of Rule 183 is problematic, because without access to the STJ's report, it is utterly impossible for a reviewing Article III court to determine if the regular Tax Court Judge gave proper deference—or any deference at all—to the STJ's presumptively correct factual findings. Without a copy of the STJ's report, it is not possible to know which, if any, of the STJ's fact-findings the reviewing Tax Court Judge changed. In other words, the veil of secrecy that shrouds the STJ's initial fact-findings denies taxpayers Article III review in practice, if not in name.

2. *Once Authorized by Congress, Article III Review Cannot Be Hampered by the Unilateral Action of the Non-Article III Court.*

Congress has given taxpayers the right to have their Tax Court cases reviewed by Article III courts "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." 26 U.S.C. § 7482(a)(1). With Congress having granted taxpayers the right to seek Article III review of the Tax Court's decisions,

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[17] ". . . the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Tax. Ct. R. 183(c).

the Tax Court may not unilaterally strip that right away. Yet, the Tax Court has done just that by making this Congressionally mandated review impossible by virtue of its aberrant procedure.

Further, all parties who come into conflict with the federal government have a right to effective review by an Article III court. Even in so-called "public rights" cases, this Court has upheld the use of Article I courts *only* insofar as the private parties have been given the statutory right to appeal to an Article III court. *See, e.g., Crowell v. Benson*, 285 U.S. 22, 54 (1932) (upholding Article I adjudication of claims under Longshoremen's and Harbor Workers' Act because review by Article III court was possible); *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 592 (1985) (upholding Article I adjudication of FIFRA claims because "FIFRA at a minimum allows private parties to secure Article III review of the arbitrator's 'findings and determination' for fraud, misconduct, or misrepresentation"); *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 85, 87 (1982) (holding that Article III review of the bankruptcy court under the "clearly erroneous" standard was not rigorous enough to save the statute); *id.* at 70 n.23 (noting that "[even] when Congress assigns ['public rights'] matters to administrative agencies, or to legislative courts, it has generally provided, and we have suggested that it may be required to provide, for Article III judicial review"); *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 853 (1986) (upholding a CFTC adjudicatory scheme after noting that Congress permitted meaningful judicial review).[18]

[18] *See also* Richard H. Fallon, *Of Legislative Courts, Administrative Agencies, and Article III*, 101 HARVARD L. REV. 915, 933 (1988) (concluding that meaningful judicial review in an Article III court is required by the Constitution); Richard B. Saphire & Michael E. Solimine, *Shoring Up Article III: Legislative Court Doctrine in the Post CFTC v. Schor Era*, 68 BOSTON U. L. REV. 85, 135, 149 (1988) (asserting that judicial review by an Article III court is a necessary but insufficient requirement of any delegation of judicial power).

Effective appellate review requires that the appellate court have access to the original and unaltered factual findings, as made by the person or persons making such findings. Without a record of a jury's unrevised verdict, for example, no appellate court could possibly conduct an effective review of a trial judge's grant of judgment as a matter of law. This principle is so obvious that citations are unavailable: prior to the Tax Court's change in practice in 1984, no American court had ever attempted to keep original fact-findings secret. As Judge Cudahy said, "No court of which I am aware has ever considered the ramifications of an agency's swallowing and refusing to regurgitate a preliminary factual finding in the manner done by the Tax Court here." *Kanter*, 337 F.3d at 886 (Cudahy, J., dissenting).

Indeed, in interpreting the Administrative Procedure Act, this Court concluded that, when reviewing a decision from the National Labor Relations Board, the record that the Article III court is provided must include the fact-finding report prepared by the examiner and reviewed by the Board. *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 493 (1951) ("Surely an examiner's report is as much a part of the record as the complaint or live testimony."). The statute at issue in this case, 26 U.S.C. § 7482, requires no less.

It is beyond dispute that when the courts of appeals review decisions of "district courts in civil actions tried without a jury," they are able to examine the original fact-findings of the district court or any subordinate fact-finder (such as, for instance, a magistrate judge). Under Rule 52(a) of the Federal Rules of Civil Procedure, the district judge must "find the facts specially and state separately its conclusions of law thereon." Paralleling Tax Court's Rule 183, Rule 52(a) also requires that "[f]indings of fact . . . shall not be set aside

unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge . . . the credibility of the witnesses."

Where a district judge has employed the services of a magistrate or special master in a bench trial, no appellate court would tolerate the district judge's attempt to revise or manipulate the factual findings behind the scenes, without ever apprising the appellate court of the original findings. It would also be impossible for a district judge to simply keep the magistrate's original findings secret, whether or not those findings had ever been changed. Such actions would be inconceivable, and would self-evidently render effective appellate review impossible.[19] *Cf. Universal Camera*, 340 U.S. at 493. Similarly, the fact-finding reports prepared by federal bankruptcy judges must be disclosed to the district court and shared with the parties. FED. R. BANKR. P. 9033.

[19] Indeed, there has long been a debate over what standard of review should be applied by the appellate court where a district court has disagreed with another fact-finder (such as a master). *See Stone*, 865 F.2d at 347-48 (discussing the conflict); STEVEN ALAN CHILDRESS & MARTHA S. DAVIS, 1 FEDERAL STANDARDS OF REVIEW, at § 2.03C (1999) (same). Most courts have held that the appellate court should ignore the intermediate step (*i.e.*, the district court) and review the original fact-finder's results *directly*. *See, e.g., Morris Plan Indus. Bank v. Henderson*, 131 F.2d 975 (CA2 1942) (Hand, J.); *Gottlieb v. Barry*, 43 F.3d 474, 486-87 & n.9 (CA10 1994) (holding that district court must respect a master's determination if it is "similar to a credibility finding"); *Cook v. Niedert*, 142 F.3d 1004, 1009-12 (CA7 1998); *In re Multiponics, Inc.*, 622 F.2d 709, 723 (CA5 1980); *O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1, 4-5 (CA8 1961); *Lines v. Falstaff Brewing Co.*, 233 F.2d 927, 930 (CA9 1956). A few courts, on the other hand, have given more deference to the district court's views. *See, e.g., Milliken Research Corp. v. Dan River, Inc.*, 739 F.2d 587, 592-93 (Fed. Cir. 1984); *United States v. Twin City Power Co.*, 248 F.2d 108, 112 (CA4 1957). Crucially, however, this entire debate would be absolutely impossible unless everyone took for granted that the appellate court must, at the very least, be informed of ***what the original fact finder's conclusions were***.

When it guaranteed Article III review of the decisions of the Tax Court, Congress was presumptively aware of the universal practice of providing the appellate courts with a copy of the trier of facts' findings. Congress did nothing to exempt the Tax Court from this procedural norm. Quite the opposite, Congress's enactment of 26 U.S.C. § 7482(a)(1) explicitly guaranteed that a taxpayer's case is to be reviewed "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury"—and it is undisputed that an appellate court has access to all fact-findings made by the trier of facts in the district court. Thus, consistent with *Universal Camera* and this universal procedural norm, 26 U.S.C. § 7482 implicitly insures the appellate courts access to the STJ's report.

3. *A Reviewing Article III Court Must Be Able to Determine if the Tax Court Gave Proper Deference to the STJ's Findings of Fact.*

The D.C. Circuit held in *Stone*, 865 F.2d 342, that the combination of Section 7482 and Tax Court Rule 183 (then labeled Rule 182) required (1) the Tax Court to apply a clear error standard of review to the Special Trial Judge's findings and (2) the court of appeals to apply clear error review to the Tax Court's own review process. *Stone*, 865 F.2d at 348. The court said:

> If a simple "preponderance" of the evidence—half plus a little bit—suffices to overturn the factual findings of a Special Trial Judge, then it is difficult to see what value or force attaches to the presumptive correctness of that judge's factual determinations, much less the "due regard" owed "to the circumstance that the [Special Trial Judge] had the opportunity to evaluate the credibility of witnesses."

Id. at 347.

In other words, when an Article III court of appeals is reviewing a Tax Court decision, it must assure itself that the

Tax Court has not committed any clear error in its own review of the Special Trial Judge's report. This sort of Article III review is absolutely impossible, however, where the Tax Court refuses to let the court of appeals view the Rule 183 report.

While the STJ was the only person in a position to make credibility determinations in a fraud case involving fifty-five witnesses, the Tax Court refused to make the initial findings of Judge Couvillion available to the Eleventh Circuit, even on a sealed basis. The Tax Court simply declared that "Judge Dawson gave ***due regard*** to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses." T.C. Order, Pet. App. at 315a (emphasis added). Respectfully, the Tax Court's "take our word for it" stance is not enough; the appellate court must be allowed to see for itself how much "regard" Judge Dawson actually gave to Judge Couvillion's original credibility findings. Only when armed with a copy of the Rule 183 report can the appellate court answer the questions that it is obliged to ask: Did Judge Dawson apply the correct standard of review to the STJ's factual findings? Did he apply that standard of review correctly? Did Judge Dawson make credibility assessments contrary to those made by Judge Couvillion? If Judge Dawson did reverse Judge Couvillion's credibility assessments, was this reversal based on something that appeared in the record or something else? Were Judge Dawson's contrary credibility assessments based on adequate record evidence? Self-evidently, none of these essential appellate questions can be answered so long as Judge Couvillion's report is kept secret by the Tax Court.

Thus, while Congress and the Constitution have given taxpayers the right to have their case reviewed by Article IH judges "in the same manner and to the same extent as decisions of the district courts in civil cases tried without a jury," 26 U.S.C. § 7482, that review cannot meaningfully

occur when the Tax Court hides a report that in any other American court would be part of the public record. In sum, by establishing its secret procedures under Rule 183, the Tax Court has unilaterally undermined the plainly-expressed intent of Congress. This is manifestly improper, and the Tax Court should be compelled to comply with 26 U.S.C. § 7482. Fortunately, the mere disclosure of the STJ's Rule 183 report to the parties and the reviewing courts would achieve such compliance.

D. Because Fact-finding May Not Be Made By Proxy, the STJ Must Be Regarded as the Original Finder of Fact and Not a Mere Stenographer for the Absent Regular Tax Court Judge.

The second explanation put forward by the IRS for the Tax Court's fact-finding procedure under Rule 183 is that the regular Tax Court Judge, informed by the STJ's secret report and, possibly, the trial transcript, actually makes the "initial" fact-findings.[20] Under this analysis, the STJ is merely some sort of "aide" to the *bona fide* fact-finder, the absent-from-trial regular Tax Court Judge.[21] Similarly, the STJ's report is merely an internal court communication and thus enjoys the same status as, for example, a law clerk's "bench memo" to a judge. As an internal court document, the theory goes, the STJ's report is properly kept confidential. In other words, under this understanding of Rule 183, the "original" fact-findings are made by the regular Tax Court Judge, not the STJ, and the STJ's report is therefore of no real consequence to the parties or the appellate courts.

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[20] *See* Brief for the Respondent in Opposition at 11, n.2; Appellee's Brief in the Eleventh Circuit at 75-76.

[21] *Id.*

As described above, this is an explanation that the plain language of Rule 183 will simply not bear. Under Rule 183, the STJ's factual findings are "presumed to be correct" and thus enjoy legal status independent of and apart from any evaluation of the facts by a regular Tax Court Judge. In sharp contrast, a genuine internal court document, such as a law clerk memo or draft opinion, self-evidently lacks any independent legal status and is certainly not "presumed to be correct." In other words, because it defined the STJ's fact findings as presumptively correct in Rule 183, the Tax Court is now estopped from denying either that those fact-findings have legal authority or that they are a necessary part of the record.

Nor, indeed, does defining the STJ as an "aide" to the regular judge describe the reality before the Tax Court, in which the STJ is the ***only*** judge who conducts the trial, ruling on all evidentiary and other motions, taking all testimony, hearing and questioning the witnesses, and making findings of fact and conclusions of law. *Freytag*, 501 U.S. at 881-82.

Nonetheless, the Government has suggested this reading of Rule 183, under which while the STJ presided at trial and heard the testimony, he did so merely as a proxy for the absent fact-finder—the regular Tax Court Judge. To be sure, the judicial practice of assigning various administrative functions to subordinates is both routine and generally acceptable. Neither does anyone challenge that internal Court communications, such as drafts of opinions or a judge's notes, are properly kept confidential. No one would argue, for example, that parties have the right to see research memoranda or drafts prepared for a judge by his law clerk. Thus, it seems that the Tax Court believes that the STJ is no different from a law clerk; the STJ merely functions as an aide to the Tax Court Judge who is thereby relieved of the tedium of observing the witnesses. Under this conception of Rule 183, the STJ is not a "trial judge" in any real sense, but merely a sort of scribe taking notes on behalf of the

otherwise-occupied actual Tax Court Judge. This, of course, is precisely where the Tax Court has gone wrong.

It should be obvious that an opportunity to observe a witness is necessary to make a meaningful credibility determination. Likewise, "one of the essential elements of the determination of the crucial facts [to any case] is the weighing and appraising of testimony." *Holiday v. Johnston*, 313 U.S. 342, 352 (1941).[22] That is especially true where, as here, the central issue is a fact-bound question such as the presence of fraudulent intent.

Because of his unique proximity to the live testimony, the trier of fact's decision is always subject to a deferential standard of review, whether he wears the title judge, juror, magistrate, or "special trial judge." In jury trials, the verdict can be set aside only "where no rational juror could so find."[23] In bench trials, fact-findings may not be set aside absent "clear error."[24] In both settings, it is univers-

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[22] *See also Universal Camera*, 340 U.S. at 496 ("The significance of [the hearing examiner's] report, of course, depends largely on the importance of credibility of witnesses."); *Morgan v. United States*, 298 U.S. 468, 481 (1936) ("That duty cannot be performed by one who has not considered evidence or argument. . . . The one who decides must hear."); *Gottlieb*, 43 F.3d at 486-87 & n.9 (holding that district court must respect a master's determination if it is "similar to a credibility finding"); *United States v. Marshall*, 609 F.2d 152, 155 (CA5 1980) (only in a "rare case" should a district judge resolve credibility choices in manner contrary to recommendation of magistrate who heard witnesses' testimony); *Bennerson v. Joseph*, 583 F.2d 633, 641 (CA3 1978) (district court serves in a reviewing capacity and should not displace master's view of witnesses' credibility); *Nat. R.R. Passenger Corp. v. Koch Indus., Inc.*, 701 F.2d 108, 111 (CA10 1983) (discussing importance of respecting a master's determinations that are "similar to a credibility finding").

[23] *E.g., Boeing Co. v. Shipman*, 411 F.2d 365 (CA5 1969) (en banc) (civil); *Jackson v. Virginia*, 443 U.S. 307 (1979) (criminal).

[24] *Barnett Bank v. Gallagher*, 43 F.3d 631, 633 (CA11 1995), *rev'd on other grounds*, 517 U.S. 25 (1996).

ally accepted that credibility assessments cannot be second-guessed by those who were not present.[25]

There can be no doubt that seeing a witness testify live assists the finder of fact in evaluating the witness's credibility. As this Court stated in *Anderson v. Bessemer City*, 470 U.S. 564 (1985): "[O]nly the trial judge can be aware of the variations in demeanor and tone of voice that bear so heavily on the listener's understanding of and belief in what is said." *Id.* at 575. Live testimony enables the finder of fact to see the witness's physical reactions to questions, to assess the witness's demeanor, and to hear the tone of the witness's voice—matters that cannot be gleaned from a written transcript. This is not only true of the federal system. It is equally true in all fifty states. 5 C.J.S. *Appeal and Error* § 781 (1993) (compiling state rules and cases).

The fact-finding function is not one that could be assigned to a law clerk or other court staff on behalf of an absent judge. This is indisputable. For example, it would rightly create a scandal for a judge to leave the courtroom during a bench trial and place his law clerk on the bench, with instructions to take notes and report back to him on who was telling the truth. Deciding who is lying and who is telling the truth is a fundamentally difficult task, particularly in a fraud case such as this, that simply cannot be accomplished by proxy, at a distance, or from a cold record.[26] Yet, under this understanding of Rule 183, the Tax Court proposes to engage in precisely this sort of absentee fact-finding-by-proxy.

In *United States v. Raddatz*, 447 U.S. 667 (1980), this Court upheld the constitutionality of the Magistrates Act only

[25] *United States v. Mejia*, 69 F.3d 309, 315-16 (CA9 1995); *Henson v. CIR*, 835 F.2d 850, 853 (CA11. 1988).

[26] *Goldberg v. Kelly*, 397 U.S. 254, 269 (1970) ("Particularly where credibility and veracity are at issue . . . written submissions are a wholly unsatisfactory basis for decisions.").

because there was no reason to believe that credibility determinations had been rejected. In that case, a federal district judge had upheld a magistrate's finding that a criminal defendant had confessed voluntarily. In doing so, the judge had not recalled the witnesses to repeat their testimony. In rejecting due process and Article III objections, a plurality of the Court explicitly noted that it was ***not*** confronted with a district court rejecting a magistrate's fact-finding without personally observing the witnesses. *Raddatz* at 681 n.7. "To do so," observed the Court, "without seeing and hearing the witness or witnesses whose credibility is in question could well give rise to serious questions [beyond the question presented]." *Id.* Indeed, this concern was not only noted by the plurality in *Raddatz*, it was also the central feature of the concurring and dissenting opinions, joined collectively by five Justices, all of whom apparently agreed that the Due Process Clause would never permit a district court to reject a magistrate's credibility finding without personally observing the witness or witnesses.[27]

Subsequent decisions of this Court have continued to assume, and decisions of the lower courts have held, that a federal district judge may not constitutionally substitute his credibility determinations for those of the magistrate judge

[27] *See Raddatz*, 477 U.S. at 684 (Blackmun, J., concurring) ("I would distinguish between instances where the district court rejects the credibility-based determination of a magistrate and instances, such as this one, where the court adopts a magistrate's proposed result."); *Id.* at 686-87 (Powell, J., concurring in part and dissenting in part) (arguing that where credibility issues are concerned, the Article III judge must conduct his own hearing of the witnesses whether or not he wishes to reverse the magistrate); *Id.* at 691 (Stewart, J., joined by JJ. Brennan and Marshall) (arguing that the district judge could *never* decide a motion to suppress "without being exposed to the one kind of evidence that no written record can ever reveal—the demeanor of the witnesses.").

who observed the live testimony.[28] The rule applies equally in civil and criminal settings. *See, e.g., Parker v. Heckler*, 763 F.2d 1363, 1365 n.2 (CA11 1985); *Zand v. CIR*, 143 F.3d 1393, 1400 n. 15 (CA11 1998) (quoting the Tax Court). Similarly, where a case has been tried to the bench and the judge who heard the case below is no longer available on remand, the new judge will normally be required to recall and hear each of the witnesses himself. *See, e.g., United States v. Mitchell*, 187 F.3d 331, 332-33 (CA3 1999). Even the Tax Court acknowledges this. *Zand*, 143 F.3d at n.15.

In sum, to the extent that Tax Court Rule 183 reduces the STJ to the role of a mere tape recorder operator or note-taker for the regular Tax Court Judge, who makes the "actual" fact-findings, it offends due process. As the only judicial officer to have heard the testimony and observed the witnesses, the STJ is the only person in position to make constitutionally valid credibility determinations. This is not, of course, to argue that a regular judge of the Tax Court is not entitled to review the STJ's factual findings, provided it is the STJ who, in the first instance, made those findings. Further, the regular Tax Court Judge's review should be undertaken under some deferential standard, or at least in a way that allows the Article III appellate courts to know what findings were made by the judge who actually tried the case and observed the witnesses. But, in all events, it must be the STJ and not the absent Tax Court Judge, who makes the "original" fact-findings.

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[28] *See Peretz*, 501 U.S. at 939 (observing that, in some cases, the magistrate's determination might "turn[] on the credibility of witnesses" and noting that "[w]e presume, as we did in *Raddatz* when we upheld the provision allowing reference to a magistrate of suppression motions, that district judges will handle such cases [*i.e.*, cases hinging on credibility findings] properly if and when they arise."); *Louis v. Blackburn*, 630 F.2d 1105, 1109-10 (CA5 1980); *United States v. Cofield*, 272 F.3d 1303, 1305-06 (CA11 2001).

E. To the Extent that the Tax Court's Findings of Fact Are the Product of Some Sort of "Judicial Conference" or "Collaborative Effort" Between the STJ and the Regular Tax Court Judge, Due Process Is Again Violated.

The final characterization offered by the IRS of the relationship between the STJ and the regular Tax Court Judge under Rule 183 is that they are peers who confer and collaborate to produce the Tax Court's findings of fact. This is the characterization that the Eleventh Circuit ultimately accepted, noting,

> [w]hile the procedures used in the Tax Court may be unique to that court, there is nothing unusual about judges conferring with one another about cases assigned to them. These conferences are an essential part of the judicial process when, by statute, more than one judge is charged with the responsibility of deciding the case.

Ballard, 321 F.3d at 1042-43. The Eleventh Circuit also observed that "as a result of such conferences, judges sometimes change their original position or thoughts." *Id.* at 1043. Thus, under this understanding of Rule 183, although only the STJ attends the trial and hears the evidence, the STJ and the Regular Tax Court Judge are jointly responsible for making the "original" fact-findings through conference and discussion.[29]

The due process problems inherent in this interpretation of Rule 183 are manifest and numerous.

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[29] *See* Brief for the Respondent in Opposition to Petition for Writ of Certiorari at 15 ("Nor do the communications that occur among judges with a collaborative responsibility represent prohibited ex parte communications . . internal communications among judges and special trial judges are part of the internal deliberative process of the court.").

1. Ex Parte *Contact Between the Finder of Fact and the Judge Is not Helpful to Fact-finding and Injects Uncertainty and Confusion Over Why the Credibility Determinations Were Made the Way They Were.*

Under the IRS's most recent professed understanding of Rule 183,[30] the only possible fact-finder's conclusions must be revealed *ex parte* to the judge, who may then "correct" them as he sees fit, all entirely off the record. In other words, the Eleventh Circuit's ruling not only permits but requires *ex parte* contact between the finder of fact (the STJ) and the judge before the finder of facts' conclusions are disclosed and without the creation of any record of either the original fact-findings or the *ex parte* contact.

However, because the STJ is the only Tax Court judicial officer to hear the testimony and observe the witnesses, he is the only constitutionally permissible finder of fact at a Tax Court trial. *See Raddatz*, 447 U.S. at 681 n.7; *Peretz*, 501 U.S. at 939. It is undisputed that neither the Chief Judge nor the regular Tax Court Judge assigned to this case attended the trial. Neither is either obligated by any statute or rule to read the trial transcript. It is also undisputed that the STJ is an employee-at-will of the Tax Court. Pursuant to the express language of Rule 183, the function of the Tax Court Judge is to review the STJ's report and ensure that the law is properly applied and that the factual conclusions are not clearly erroneous. While a conference between peer judges concerning legal issues is certainly permissible, the IRS has never offered any explanation as to what, if anything, the absent reviewing judge could possibly add to the ***factual***

[30] *See* Brief for the Respondent in Opposition to Petition for Writ of Certiorari at 15 (characterizing the regular Tax Court Judge's off-the-record review and correction of the STJ's fact-findings as "collaborative judicial process").

determination of whether the live trial testimony is credible. Nor has the IRS explained why the same judge who is reviewing the STJ's fact-findings for "clear error" or with "due regard" should be involved in making those findings at the outset. Worse still, without any record of that judge's role, all this process creates is confusion and mystery as to why the facts were decided as they were.

The assertion that the Tax Court is permitting—much less requiring—secret *ex parte* contact between the finder of fact and the judge is without precedent in any forum where disputed issues of fact—much less assertions of fraud—are tried. Quite to the contrary, in the federal system there exists a clear and long-standing prohibition against the trial judge even discussing the fact issues with the jurors before their verdict (*i.e.*, the jury's fact-finding) has been announced. *E.g.*, *United States v. United States Gypsum Co.*, 438 U.S. 422, 459-62 (1978); *United States v. Cowan*, 819 F.2d 89, 93-94 (CA5 1987) (reversing conviction where judge engaged in *ex parte* communications with jurors); *United States v. Yonn*, 702 F.2d 1341, 1345 (CA11 1983) (discussing significance of adequate record to access role of *ex parte* contact). This prohibition is rooted firmly in due process. *E.g.*, *United States v. Frazin*, 780 F.2d 1461, 1469 (CA9 1986); *Delgado v. Rice*, 67 F. Supp. 2d 1148, 1157-58 (C.D. Cal. 1999).

Similarly, *every* state judicial system (by rule or court decision) has also prohibited *ex parte* communications between judges and jurors while fact issues are in play.[31] Indeed, state

[31] *Matthews v. Liberty Mut. Ins. Co.*, 243 So. 2d 703 (Ala. 1971); *Frontier Cos. v. Jack White Co.*, 818 P.2d 645 (Alaska 1991); *Perkins v. Komarnyckyj*, 834 P.2d 1260 (Ariz. 1992); *Coran v. Keller*, 748 S.W.2d 349 (Ark. 1988); *Halada v. Venice Lake Park, Inc.*, 283 P.2d 42 (Cal. Ct. App. 1955); *Kimmins v. City of Montrose*, 151 P. 434 (Colo. 1915); *Aillon v. State*, 363 A.2d 49 (Conn. 1975); *Loatman v. Patillo*, 401 A.2d 91 (Del. 1979); *Sears Roebuck & Co. v. Polchinski*, 636 So. 2d 1369 (Fla. Dist. Ct. App. 1994); *Gibson v. Gibson*, 187 S.E. 155 (Ga. Ct. App. 1936); *State v.*

courts often take the view that such conduct is reversible without objection[32] and so serious that harm is to be presumed.[33] Again, both of these conclusions stem from the fact

Estrada, 738 P.2d 812 (Haw. 1987); *Rueth v. State*, 596 P.2d 75 (Idaho 1978); *Gale v. Hoekstra*, 375 N.E.2d 456 (Ill. App. Ct. 1978); *Rogers v. R.J. Reynolds Tobacco Co.*, 745 N.E.2d 793 (Ind. 2001); *Ragee v. Archbold Ladder Co.*, 471 N.W.2d 794 (Iowa 1991); *Scales v. St. Louis-San Francisco Ry.*, 582 P.2d 300 (Kan. Ct. App. 1978); *Goode v. Campbell*, 77 Ky. 75 (1878); *Jones v. Black*, 676 So. 2d 1067 (La. 1996); *Greely v. Weaver*, 5 A. 267 (Me. 1886); *Smith v. State*, 505 A.2d 564 (Md. Ct. Spec. App. 1986); *Commonwealth v. DeJesus*, 691 N.E.2d 234 (Mass. App. Ct. 1998); *People v. France*, 461 N.W.2d 621 (Mich. 1990); *Booth v. Spindler*, 110 N.W.2d 889 (Minn. 1961); *Boedges v. Dinges*, 428 S.W.2d 930 (Mo. Ct. App. 1968); *Gulf Hills Dude Ranch, Inc. v. Brinson*, 191 So. 2d 856 (Miss. 1966); *State Highway Comm'n v. Dunks*, 531 P.2d 1316 (Mont. 1975); *Taulborg v. Andresen*, 228 N.W. 528 (Neb. 1930); *Isbell v. State*, 626 P.2d 1274 (Nev. 1981); *State v. Bailey*, 503 A.2d 762 (N.H. 1985); *Guzzi v. Jersey Cent. Power & Light Co.*, 115 A.2d 629 (N.J. Super. Ct. App. Div. 1955); *Amador v. Lara*, 603 P.2d 310 (N.M. Ct. App. 1979); *Linke v. Savage*, 333 N.Y.S.2d 600 (N.Y. App. Div. 1972); *Sheff v. Conoco, Inc.*, 311 S.E.2d 14 (N.C. Ct. App. 1984); *Kronberger v. Zins*, 463 N.W.2d 656 (N.D. 1990); *Bostic v. Connor*, 524 N.E.2d 881 (Ohio 1988); *Osage Mercantile Co. v. Harris*, 152 P. 408 (Okla. 1915); *Hastings v. Top Cut Feedlots, Inc.*, 590 P.2d 1210 (Or. 1979); *Glendenning v. Sprowls*, 174 A.2d 865 (Pa. 1961); *Amica Mut. Ins. Co. v. Tashjian*, 703 A.2d 93 (R.I. 1997); *State v. Dawkins*, 232 S.E.2d 228 (S.C. 1977); *Gilbert v. Caffee*, 293 N.W.2d 893 (S.D. 1980); *Guy v. Vieth*, 754 S.W.2d 601 (Tenn. 1988); *Conrey v. McGehee*, 473 S.W.2d 617 (Tex. Civ. App.-Houston [14th Dist.] 1971, writ ref'd n.r.e.); *Johnson v. Maynard*, 342 P.2d 884 (Utah 1959); *State v. Loso*, 559 A.2d 681 (Vt. 1989); *Ellis v. Commonwealth*, 317 S.E.2d 479 (Va. 1984); *Iverson v. Pacific Am. Fisheries*, 442 P.2d 243 (Wash 1968); *Klesser v. Stone*, 201 S.E.2d 269 (W.Va. 1973); *State v. Burton*, 334 N.W.2d 263 (Wis. 1983); *Carlson v. Carlson*, 888 P.2d 210 (Wyo. 1995).

[32] *Smith v. State*, 505 A.2d 564 (Md. Ct. Spec. App. 1986); *People v. France*, 461 N.W.2d 621 (Mich. 1990).

[33] *Rogers v. R.J. Reynolds Tobacco Co.*, 745 N.E.2d 793 (Ind. 2001); *Glendenning v. Sprowls*, 174 A.2d 865 (Pa. 1961); *Guy v. Vieth*, 754 S.W.2d 601 (Tenn. 1988).

that *ex parte* communications between a judge and jurors are inherently inconsistent with due process. *E.g.*, *State v. McGinnes*, 967 P.2d 763, 769-70 (Kan. 1998); *Guzzi v. Jersey Cent. Power & Light Co.*, 115 A.2d 629, 634-35 (N.J. Super. Ct. App. Div. 1955).

The prohibition on *ex parte* contact between finders of fact and those who supervise their work extends beyond the traditional judge-and-jury courtroom context. Indeed, it is universal. United States magistrate judges, for example, must disclose their decisions to the parties before they are reviewed or corrected by a federal district judge, and the parties are given the opportunity to object to the magistrate's findings.[34] 28 U.S.C. § 636(b)(1)(c); FED. R. CIV. P. 72 and 73. Similarly, the drafters of the Administrative Procedures Act ("APA") made it perfectly clear that when an Administrative Law Judge ("ALJ") has considered the evidence and reached a factual conclusion or recommended a decision, his finding or recommendation was to be shared with the parties ***before*** any outside influence was brought to bear by his superiors. 5 U.S.C. § 557(c) ("[a]ll decisions, ***including initial, recommended and tentative decisions***, are a part of the record") (emphasis added) and § 557(d) (forbidding *ex parte* contact).[35] Thus, the APA rightly embraces the general rule

[34] In addition, in contrast to the situation in the Tax Court, Article III appellate courts obviously have access to a magistrate's initial fact-findings, as well as the federal district judge's reasons for changing those findings. Further, federal magistrate judges enjoy the protection of a defined term of office, 28 U.S.C. § 631(d), while the Tax Court's STJs are employees-at-will, and thus vastly more susceptible to pressure in the purportedly "collaborative" process. *See infra*.

[35] The drafters provided a limited exception for initial license applications where the agency rule required the entire record to be certified to it– cases that by definition do not involve existing property rights or equate to traditional adjudications.

that "[t]he one who decides must hear"[36]—with that decision made free of *ex parte* contact or outside influence.

Like a juror, an administrative law judge, or a magistrate judge, the STJ is alone in observing the witness and in determining, at least as an initial matter, whether testimony is to be credited. But, unlike any of these other fact-finders, the STJ is not insulated from *ex parte* contact prior to the release of his factual determinations. Even worse, the STJs' future employment and livelihood are entirely dependent on the good will of the Chief Judge. Nonetheless, under the IRS's theory and the Eleventh Circuit's ruling, the STJ is obligated to engage in a secret *ex parte* "conference" with a regular Tax Court Judge and to submit his factual findings for pre-release "correction." Thus, this interpretation of Rule 183 violates the universal American prohibition on *ex parte* contact between fact finder and judge.

2. *Any Collaborative Effort to Make Fact-findings by the Present-at-Trial STJ and the Absent-from-Trial Tax Court Judge Makes It Impossible to Know that the Decision Maker Observed the Testimony.*

In addition to exposing the finder of fact to *ex parte* pressure, classifying the Tax Court's fact-finding process as a behind-closed-doors collaborative effort between the present-at-trial STJ and an absent-from-trial Tax Court Judge makes it is impossible to verify that the person making the factual determinations heard the live testimony and observed the witnesses. To the extent that the absent-from-trial Tax Court Judge is given a voice in making original factual findings, rather than simply reviewing the findings made by the STJ, the universal principal, set forth above, that "[o]nly the trial judge can be aware of the variations in demeanor and tone of

[36] *Morgan v. United States*, 298 U.S. 468, 481 (1936).

voice that bear so heavily on the listener's understanding of and belief in what is said" is ignored.[37]

Further, making fact-findings via an off-the-record collaborative process between the STJ and the Tax Court Judge makes meaningful appellate review impossible because it obscures the standard of review applied by the regular Tax Court Judge to the STJ's report. In other words, treating the fact-finding process at the Tax Court as a confidential judicial conference makes it impossible to know which factual determinations were made by whom, while rendering indeterminable the level of deference ("due regard") given to the STJ's report, as commanded by Rule 183, and making the court of appeals' own clear-error review of the findings of fact contained in the opinion impossible. *See Kanter*, 337 F.3d at 884-85 (Cudahy, J., dissenting) (noting that clear error review requires more deference be given to the judge who heard the witnesses; meaningful clear error review thus requires knowledge of which entity was the finder of each fact).

3. *No "Judicial Conference" Between the STJ and the Tax Court Judge Is Possible Because They Are not Peers.*

Finally, the Eleventh Circuit's decision to treat the Tax Court's Rule 183 fact-finding process as nothing more than a confidential "judicial conference" with the potential to "sometimes change [the STJ's] original position or thoughts"[38] ignores the critical fact that the STJ and the regular Tax Court Judge are in no way peers. Quite the contrary, the STJ is an employee-at-will of the Tax Court who, in a very real sense, is facing his employer when he "confers" with a regular judge of the Tax Court. Unlike a

[37] *Anderson*, 470 U.S. at 575.

[38] *Ballard*, 321 F.3d at 1043; Brief for the Respondent in Opposition to Petition for Writ of Certiorari at 15.

federal magistrate or bankruptcy judge, the STJ is not even protected by a fixed term of office.

While a conference between judicial peers, such as judges on a federal appellate court or another multi-judge panel of equals, serves an undeniably valuable purpose, there is simply no analogy to the secret meetings between employer and employee held at the Tax Court. At a minimum, an employee-at-will STJ is vastly more susceptible to pressure in a "conference" with his employer than any other type of judge in the federal system would be in a traditional judicial conference. Given the inherent inequality in their positions, STJs and regular Tax Court Judges are simply not capable of conferring in the same manner that peer judges do. *Kanter*, 337 F.3d at 887 (Cudahy, J., dissenting) ("The STJs are not equal to the Tax Court judges and it might be naive to assume that the STJs have an equal voice in the collaborative process that results in Tax Court opinions.").

Further, judges on a multi-judge panel have, as a general rule, all heard the same testimony or observed the same oral argument. As such, a conference allows them to compare perspectives and impressions based on their shared observations.

That is not the case here, where one of the "conferring" judges witnessed the trial and the other did not. Thus, the argument advanced by the IRS equates the Tax Court's Rule 183 procedure to some sort of "conference" between a trial judge and a judge of the court of appeals. In other words, even if the STJ and the Tax Court Judge were peers capable of conferring on equal terms, no meaningful conference between them is possible. Given that he did not attend the trial, it is entirely unclear what the regular Tax Court Judge could possibly say in conference to persuade the present-at-trial STJ to "change their original position or thoughts"[39] on the credi-

[39] *Ballard*, 321 F.3d at 1043.

bility of witnesses. Indeed, the absent-from-trial Tax Court Judge would seemingly have nothing to contribute to the sort of fact-finding conference envisioned by the Eleventh Circuit.

Finally, to the extent that an STJ's view of the facts does not prevail in the confidential "conference" with a regular Tax Court Judge, the STJ has no ability to publish a dissent or otherwise memorialize his objections—even if the STJ is bold enough to disagree with his employer. This is, of course, markedly different from any conventional judicial conference, such as among the judges of a court of appeals, in which every conferring judge has the ability to dissent on the record.

II. THE TAX COURT'S STRUCTURE OF ADJUDICATION VIOLATES DUE PROCESS.

Having established that, no matter how it is characterized, the Tax Court's Rule 183 procedure is fundamentally out-of-step with traditional and universally accepted American judicial practices, it is next necessary to examine how, specifically, it violates taxpayers' due process rights. The Tax Court's aberrant Rule 183 violates due process for two distinct reasons. First, consistent with the principle reiterated by this Court in *Honda Motor Co. v. Oberg*, 512 U.S. 415, 430 (1994), the Tax Court's radical departure from accepted American judicial norms raises the presumption of a due process violation. Second, and separately, Tax Court Rule 183 violates the traditional test for due process announced by this Court in *Mathews v. Eldridge*, 424 U.S. 319, 334-35 (1976).

A. Consistent with the Court's Holdings in *Oberg* and Elsewhere, the Tax Court's Unprecedented Procedure Presumptively Violates the Due Process Clause.

As established above, the Tax Court's Rule 183 procedure departs from the procedures used in every other state and federal court in America. This dramatic aberration gives rise

to a presumptive due process violation under the principal confirmed by this Court in *Oberg*, 512 U.S. at 430, which held that a material departure from well-established and traditional judicial procedures creates a presumptive due process violation.

It has long been the rule that a court's adherence to due process will be judged in large part by whether its practices are consistent with the rest of the American legal system. *See, e.g., Den ex dem. Murrey v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 277 (1856) (holding that where American constitutional law provides no answer to a due process question, the court should look to the "settled usages and modes of proceeding existing in the common and statute law of England"); *Tumey v. Ohio*, 273 U.S. 510, 523 (1927) (same); *Powell v. Alabama*, 287 U.S. 45, 60-66 (1932) (conducting extensive analysis of colonial precedents related to the right to counsel).[40] "As this Court has stated from its first due process cases, traditional practice provides a touchstone for constitutional analysis." *Oberg*, 512 U.S. at 430. "When the absent procedures would have provided protection against arbitrary and inaccurate adjudication, this Court has not hesitated to find the proceedings violative of due process." *Id.*[41]

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[40] *See also* Sanford H. Kadish, *Methodology and Criteria in Due Process Adjudication—A Survey and Criticism*, 66 YALE L.J. 319, 325-35 (1957) (discussing the Court's use of historical analysis in procedural due process cases).

[41] The opposite is true as well: Where plaintiffs challenge procedures that have been universally deployed, the Court is reluctant to find a due process violation. *See, e.g., Burnham v. Superior Court of Cal., County of Marin*, 495 U.S. 604, 611-16 (1990); *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 17 (1991) (noting that "every state and federal court that has considered the question has ruled that the common-law method for assessing punitive damages does not in itself violate due process"); *Sun Oil Co. v. Wortman*, 486 U.S. 717, 730 (1988) ("'If a thing has been practiced for two hundred years by common consent, it will need a strong

Thus, for example, when the Court considered whether due process required that criminal violations be proved beyond a reasonable doubt, the Court found that the American judicial system's "virtually unanimous adherence" to this standard reflected a "profound judgment about the way in which law should be enforced and justice administered." *In re Winship*, 397 U.S. 358, 362 (1970) (quoting *Duncan v. Louisiana*, 391 U.S. 145, 155 (1968)). In *Duncan*, the Court found a due process violation where one state departed from the universal practice of allowing jury trials for serious criminal offenses. 391 U.S. at 155. Similarly, in *Oberg*, the Court held that Oregon had denied due process by disallowing any appellate scrutiny of the size of punitive damage awards, basing its holding on the fact that appellate scrutiny was permitted in the federal system and in every state except Oregon. *Oberg*, 512 U.S. at 430, 432.

As discussed in detail above, the Tax Court's Rule 183 procedure departs in multiple material ways from the procedures used in every other American court: the Tax Court keeps the trier of facts' conclusions out of the record and denies the parties access to those conclusions; it allows the off-the-record reversal of credibility findings by someone not present at trial; it makes no record of the reason that the trier of facts' findings were changed; and it allows (indeed, apparently *requires*) confidential *ex parte* contact between the trier of fact and the judge—and in a situation where the judge is the trier of fact's employer.[42] These secretive procedures

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case for the Fourteenth Amendment to affect it.'") (quoting *Jackman v. Rosenbaum Co.*, 260 U.S. 22, 31 (1922)); *Snyder v. Massachusetts*, 291 U.S. 97, 111 (1934) ("The Fourteenth Amendment has not displaced the procedure of the ages").

[42] To be sure, the denial of a traditional procedural safeguard may be excused where the court has adopted an adequate substitute procedure. *Oberg*, 512 U.S. at 430-31. But the Tax Court has not even purported to adopt any procedure that would be an adequate substitute for the traditional practice by which the fact-finder's conclusions are, at the very

are unique to the Tax Court and are without precedent. As Judge Cudahy said in his dissent, the Tax Court avoids "procedural transparency in a circumstance where ***every other like process known to the law is transparent***." *Kanter*, 337 F.3d at 875 (Cudahy, J., dissenting) (emphasis added). The Tax Court's practice thus presumptively violates the Due Process Clause.[43]

Because it has not identified any legitimate public interest that is served by the Tax Court's policy of secrecy, the IRS has failed to rebut the presumption that the Tax Court's opaque fact-finding procedure violates due process. Indeed, aside from offering a flawed analogy to internal court communications, the IRS has yet to state a meaningful reason for concealing the Rule 183 report from the parties and reviewing courts. In contrast, no one would dispute that the public's interest in a transparent judicial process is both substantial and deeply-rooted. Hence, the undisputed public policy in favor of judicial transparency only serves to strengthen the *Oberg*-based presumption that due process is violated by the Tax Court's bizarrely secretive procedure.

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least, made public before they are subject to correction or review by a superior officer.

[43] Respondent might point to the fact that there exist few, if any, due process precedents that are precisely on point with the current case. Yet, this very lack of precedent is further confirmatory evidence that due process has been violated. The Court in *Oberg* observed that "[b]ecause the basic procedural protections of the common law have been regarded as so fundamental, very few cases have arisen in which a party has complained of their denial." *Oberg*, 512 U.S. at 430. Similarly, the Court observed in *Burnham* that the reason some jurisdictions lacked precedents on a particular due process issue was "because the issue was so well settled that it went unlitigated." *Burnham*, 495 U.S. at 613.

The present case involves principles of similarly unanimous lineage. The reason that there are few direct precedents for Petitioners' argument is precisely because the Tax Court's own practice is without precedent.

B. Quite Apart from the Presumption of Invalidity Under *Oberg*, the Balancing Test of *Mathews v. Eldridge* Also Requires Production of the Rule 183 Report.

Separate and independently, the Tax Court's refusal to produce the STJ's fact-findings also violates the traditional due process balancing test of *Mathews v. Eldridge*:

> [T]hree factors should be considered in determining whether the flexible concepts of due process have been satisfied: (a) the private interests implicated; (b) the risk of an erroneous determination by reason of the process accorded and the probable value of added procedural safeguards; and (c) the public interest and administrative burdens, including costs that the additional procedures would involve.

Raddatz, 447 U.S. at 677 (citing *Mathews*, 424 U.S. at 335). Each step of the *Mathews* analysis favors release of the STJ's Rule 183 report to the parties and reviewing courts.

First, the Ballards have a significant private interest in receiving fair and trustworthy appellate review in a civil fraud case. As Judge Cudahy noted in his dissent, the "quasi-criminal nature of fraud is a more significant private interest than a simple civil determination . . . ." *Kanter*, 337 F.3d at 886 (Cudahy, J., dissenting). Moreover, in some cases, even the IRS has an interest in gaining access to the Rule 183 report; if, for example, the STJ's original fact-finding had favored the IRS, only to be reversed without explanation by the regular Tax Court Judge, the IRS might well find itself championing the same position that the Petitioners do here.

Second, the risk of erroneous determination is at its apex where, as here, the appellate court is forced to speculate about what the original fact-finder thought before his views were subject to off-the-record lobbying or "correction" by his employer. As Judge Cudahy observed, "The precedents

noted in the administrative context . . . clearly demonstrate how valuable preliminary findings are for review in cases like the present one." *Id.* at 887. In simple terms, the lack of access to the Rule 183 report makes the appellate court's job harder and increases the odds of judicial error.

Third and finally, providing the parties with copies of the Rule 183 report would not violate any "public interest" or create any sort of "administrative burden." Quite the contrary, the costs involved would be exceedingly small–merely the *de minimus* cost of providing copies of the Rule 183 report to the parties and the appellate courts.[44] Again, the IRS has yet to even claim any legitimate public interest in keeping the STJ's report secret. In contrast, revealing the STJ's report to the parties, the public, and the appellate courts would obviously further the well-established public interest in judicial transparency, while maintaining secrecy undermines that interest. Indeed, it is difficult to conceive of what legitimate public interest could be furthered by the Tax Court's policy of secrecy. As Judge Cudahy put it: "This entire process of the Tax Court appears designed to extract the efficiencies involved in designating cases to be heard by STJs without having to bear any of the procedural costs traditionally associated with this kind of adjunct decision-making (*e.g.*, transparency)." *Kanter*, 337 F.3d at 887-88 (Cudahy, J., dissenting). Finally, the significant public interest in insuring adequate appellate review in all cases also is served by releasing the report.

In short, every element of the three-part *Mathews* test strongly indicates that the Tax Court's needlessly secret treatment of the Rule 183 report violates due process.

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[44] Indeed, the cost associated with producing a copy might even be assigned to the appellant as a cost of the appeal. *See, e.g.*, Proposed Amendment to Fifth Circuit Rule 30.1 (requiring party requesting the record to pay the cost of shipping it).

CONCLUSION

For all of the foregoing reasons, the judgment of the court of appeals should be vacated in its entirety, and this case remanded for further proceedings consistent with this Court's opinion, including an order that the Rule 183 report of the Special Trial Judge be provided to the parties and made part of the appellate record.

Respectfully submitted,

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APPENDIX

APPENDIX

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

[Filed Jan. 7, 2004]

No. 03-61075

In Re: ESTATE OF ROBERT W LISLE; ESTATE OF DONNA M LISLE; THOMAS W LISLE, Independent Co-Executor; AMY L ALBRECHT, Independent Co-Executor,
Petitioners,

Petition for Writ of Mandamus
to the
United States Tax Court

Before JOLLY, SMITH, and WIENER, *Circuit Judges*.

BY THE COURT:

IT IS ORDERED that the Petitioners-Appellants' Motion to Enforce This Court's Mandate, treated as a petition for writ of mandamus, is DENIED.

Although Petitioners-Appellants present a compelling case that, on remand from our opinion filed July 30, 2003, the Tax Court's stated intention to "add new penalties based on negligence, substantial understatement of income and tax-motivated interest" will exceed the strictures of our limited mandate, we remain mindful of the Supreme Court's admonition that mandamus is not to be used as a substitute for appeal. Despite the implication of the Tax Court's orders of November 19, 2003, and the inferences reasonably drawn

therefrom by Petitioners-Appellants, that Court has not issued its final judgment. Thus it is impossible to tell whether, on remand, the Tax Court will in fact exceed the narrow limits of our remand, which permits only a recalculation of tax in light of that portion of the Tax Court's original judgment that we reversed. If, in the certain knowledge that its impending judgment will be appealed and closely scrutinized to determine whether it exceeds our mandate on remand, the Tax Court does-as appellants suggest-"go much further," that contention can be dealt with in the appellate process. We trust that, in the final analysis, the Tax Court will not make yet another reversal necessary.

MOTION DENIED.

Nos. 03-184 and 03-1034

In the Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ESTATE OF BURTON W. KANTER, ET AL.,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURTS OF APPEALS
FOR THE ELEVENTH AND SEVENTH CIRCUITS

BRIEF FOR THE RESPONDENT

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QUESTIONS PRESENTED

When a case is assigned to a special trial judge of the United States Tax Court, the special trial judge is required to make a "report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will [then] assign the case to a Judge or Division of the Court." Tax Ct. R. 183(b). The Judge to whom the case is assigned "may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part." Tax Ct. R. 183(c). The questions presented are:

1. Whether the Due Process Clause requires that the "original" report of a special trial judge be made public by inclusion in the record so as to facilitate appellate review.

2. Whether 26 U.S.C. 7459(b), 7461(a), (b), or 7482 requires that the "original" report of a special trial judge be made public by inclusion in the record so as to facilitate appellate review.

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In the Supreme Court of the United States

No. 03-184

CLAUDE M. BALLARD AND MARY B. BALLARD, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

No. 03-1034

ESTATE OF BURTON W. KANTER, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES COURTS OF APPEALS FOR THE ELEVENTH AND SEVENTH CIRCUITS

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals in No. 03-184 (Ballard) (Pet. App. 1a-18a) is reported at 321 F.3d 1037. The opinion of the Tax Court (Pet. App. 19a-306a) is unofficially reported at 78 T.C.M. (CCH) 951.

The opinion of the court of appeals in No. 03-1034 (Kanter) (Pet. App. 1a-97a) is reported at 337 F.3d 833. The opinion of the Tax Court (Pet. App. 98a) is unofficially reported at 78 T.C.M. (CCH) 951.

JURISDICTION

The judgment of the court of appeals in No. 03-184 was entered on February 13, 2003. A petition for rehearing was denied on May 5, 2003 (Pet. App. 307a). The petition for a

writ of certiorari was filed on August 4, 2003, and was granted on April 26, 2004.

The judgment of the court of appeals in No. 03-1034 was entered on July 24, 2003. A petition for rehearing was denied on October 21, 2003 (Pet. App. 115a). The petition for a writ of certiorari was filed on January 20, 2004, and was granted on April 26, 2004.

The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Fifth Amendment to the United States Constitution is set forth at 03-1034 Pet. App. 116a. Sections 7443A, 7459(a) and (b), 7461(a), and 7482(a)(1) of the Internal Revenue Code, 26 U.S.C. 7443A, 7459(a) and (b), 7461(a), 7482(a)(1), and Tax Court Rule 183 are set forth in the appendix to this brief. App., *infra*, 1a-9a.

STATEMENT

Under Section 7443A(b)(4) of the Internal Revenue Code, the Chief Judge of the United States Tax Court may designate a special trial judge (STJ) to hear, but not decide, any proceeding. Where an STJ hears a case under that provision, Tax Court Rule 183 requires the STJ to prepare and submit a report of the proceeding, including recommended factual findings and legal conclusions, to the Chief Judge, who then assigns the case for decision to a regular judge of the Tax Court. See Tax Ct. R. 183(b). The judge to whom the case is assigned "may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part," and gives "[d]ue regard" to the STJ's role as hearing examiner and "presum[es]" that the STJ's factual findings are "correct." Tax Ct. R. 183(c).

In the proceedings below, the courts of appeals held that where a regular Tax Court judge adopts an STJ's report and publishes the report in an opinion, any "original" report that

the STJ may have submitted that differs from the STJ's final published report need not be disclosed to the parties or included in the record. Those decisions are correct: Well-settled principles of constitutional law and the longstanding interpretation of Tax Court procedures make clear that such disclosure is not required.

1. The Tax Court was first established in 1924 as the Board of Tax Appeals, an independent agency in the executive branch of the Government that exercised limited jurisdiction over certain tax disputes prior to the payment of the disputed tax. See Revenue Act of 1924, ch. 234, § 900(h), 43 Stat. 337. The Board became the Tax Court of the United States in 1942, see Revenue Act of 1942, ch. 619, § 504(a), 56 Stat. 957, but remained an executive agency until 1969. In that year, Congress formed the modern Tax Court as a legislative tribunal under Article I of the Constitution with authority to adjudicate specific income, estate, and gift tax disputes before payment of the tax. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 951, 83 Stat. 730; 26 U.S.C. 7441. The court is composed of 19 regular judges who are appointed for 15-year terms but may be removed by the President for "inefficiency, neglect of duty, or malfeasance in office," 26 U.S.C. 7443(e) and (f), and several STJs who are periodically appointed by the Chief Judge. See Tax Reform Act of 1984, Pub. L. No. 98-369, § 464(a), 98 Stat. 824; 26 U.S.C. 7443A(a).

STJs have statutory authority to hear cases and enter the decision of the Tax Court in declaratory judgment proceedings, "small tax cases," and levy and lien proceedings. See 26 U.S.C. 7443A(b)(1)-(3) and (c) (1994). STJs may also exercise authority under Section 7443A(b)(4) of the Internal Revenue Code to "hear" "any other proceeding which the chief judge may designate," but may not enter decisions in those cases.

See 26 U.S.C. 7443A(b)(4) and (c) (1994).[1] If an STJ hears a case pursuant to Section 7443A(b)(4), Tax Court Rule 183 requires the STJ to prepare a report, which is transmitted to the Chief Judge of the Tax Court, who then assigns the case to a regular Tax Court judge for decision. See Tax Ct. R. 183(b). The Tax Court judge may "adopt the Special Trial Judge's report" or "modify it" or "reject it in whole or in part," and gives "[d]ue regard * * * to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Tax Ct. R. 183(c).

2. This case arises out of a tax dispute between the government and Burton Kanter, Claude Ballard, and a third party, Robert Lisle. The late Burton Kanter was a well-known attorney and academic with expertise in federal income and estate taxation. 03-184 Pet. App. 45a-46a.[2] Claude Ballard is a former senior vice-president of Prudential Insurance Co. of America (Prudential), a position in which he exercised influence over Prudential's purchase and development of real estate, as well as Prudential's choice of builders and contractors for construction projects. *Id.* at 46a-47a. Like Ballard, Robert Lisle was a former Prudential vice-president, a capacity in which he exercised authority over

[1] Section 7443A(b)(4) has been re-designated as 26 U.S.C. 7443A(b)(5). See Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3401(c), 112 Stat. 749-750. Because this case was decided under the previous version of the Code, we will refer only to that version in this brief.

[2] As the court below observed, "from 1979 to 1989 Kanter, the highly successful tax attorney, who hobnobbed with Pritzkers and Hollywood producers and who participated in countless extremely large and lucrative business ventures, reported a negative adjusted gross income each year on his federal tax return and paid no federal income taxes." 03-1034 Pet. App. 2a-3a.

the award of Prudential loans and construction contracts. *Id.* at 47a.

Sometime between 1968 and 1970, Kanter met Ballard and Lisle, and the three agreed that Kanter would sell Ballard's and Lisle's influence over Prudential business and launder the proceeds through a complex network of corporations and trusts controlled by them. 03-184 Pet. App. 48a. Specifically, Kanter arranged for five individuals seeking Prudential business to pay kickbacks to an entity he controlled, called Investment Research Associates, Ltd. (IRA), or to one of IRA's subsidiaries, and those funds would then be commingled with other money in an account controlled by a different Kanter entity. *Id.* at 48-49a. Some of the funds were then distributed to Kanter, Ballard, and Lisle as "commissions, consulting fees, or directors fees." *Id.* at 49a. Larger portions of the payments were "distributed to three of IRA's subsidiaries; more specifically, 45 percent to Carlco, Inc. (Carlco) (controlled by Lisle), 45 percent to TMT, Inc. (TMT) (controlled by Ballard), and 10 percent to BWK, Inc. (controlled by Kanter)." *Ibid.* By the end of 1983, IRA had accumulated $4,771,445 in payments from the five bribers, which were distributed in the 45-45-10 ratio to TMT, Carlco, and BWK but not reported on Kanter's, Ballard's, or Lisle's tax returns. *Id.* at 5a.

After discovering the scheme, the Commissioner of Internal Revenue issued notices of deficiency to Ballard, Kanter, and Lisle, seeking unpaid taxes and, later, civil fraud penalties in connection with the millions of dollars of unreported kickbacks. 03-184 Pet. App. 5a. All three sought review in the Tax Court, and their cases were consolidated for hearing before STJ D. Irvin Couvillion pursuant to Section 7443A(b)(4). *Id.* at 33a. After a lengthy trial, in which thousands of exhibits consuming hundreds of thousands of pages were placed in evidence, STJ Couvillion submitted a report of the proceedings to then-Chief Judge

Cohen, who referred the case to Tax Court Judge Howard A. Dawson for decision. *Id.* at 5a-6a, 311a; 03-1034 Pet. App. 3a.

On December 15, 1999, Judge Dawson issued an opinion for the Tax Court, holding Kanter, Ballard, and Lisle liable for underpaid taxes and assessing a fraud tax penalty against them. 03-184 Pet. App. 19a-306a. Judge Dawson's opinion states that the Tax Court "agrees with and adopts the opinion of the Special Trial Judge," which the court "set[s] forth" in the margin of its opinion. *Id.* at 33a. The STJ opinion, in turn, analyzes the documentary and other evidence in painstaking detail and carefully traces the millions of dollars paid to IRA and its subsidiaries through the web of corporations and entities controlled by Kanter, Ballard, and Lisle, see *id.* at 49a-229a. The STJ opinion concludes that Kanter, Ballard, and Lisle had "entered into arrangements pursuant to which [Kanter] would use his business and professional contacts, including his relationships with * * * Ballard, and Lisle, to assist individuals and/or entities in obtaining business opportunities or in raising capital for business ventures" with Prudential in return for kickbacks, which Kanter would launder through "a complex organization of corporations, partnerships, and trusts," but not report as income for tax purposes. *Id.* at 48a.

3. On April 20, 2000, Kanter, Ballard, and Lisle filed a motion seeking access to "all reports, draft opinions or similar documents prepared and delivered to the Court pursuant to Rule 183(b)" by STJ Couvillion, or in the alternative for the court to include a copy of those materials in the record transmitted to the appellate court. 03-1034 Pet. App. 107a-108a.

The Tax Court denied the motion. 03-1034 Pet. App. 107a-112a. It observed that STJ Couvillion's report "ultimately became the Memorandum Findings of Fact and Opinion (T.C. Memo. 1999-407) filed on December 15, 1999," see *id.* at 108a, and that the procedures followed in the case complied

with Internal Revenue Code Section 7443A(b)(4) and Tax Court Rule 183. *Id.* at 108a-109a. Because the STJ lacked authority "actually to decide" the case, moreover, the Tax Court concluded that the motion amounted to an improper request for access to "confidential" materials that "relate to the internal deliberative processes of the Court." *Id.* at 109a.

Ballard, Kanter, and Lisle subsequently filed a motion for reconsideration, citing an affidavit from Randall G. Dick, counsel for Kanter. 03-1034 Pet. App. 99a-100a, 101a. The affidavit asserts that two or three judges of the Tax Court had informed counsel that the "original report" that STJ Couvillion submitted to the Chief Judge concluded, contrary to the report ultimately set forth in the Tax Court's decision, that the petitioners should not have been assessed a tax or a fraud penalty. *Id.* at 101a-102a.

In an opinion signed by Chief Judge Wells, Judge Dawson and STJ Couvillion, see 03-184 Pet. App. 315a-316a, the court again denied the motion. *Id.* at 312a-316a. The court's order states that "[t]he only official Memorandum Findings of Fact and Opinion by the Court in these cases is T.C. Memo. 1999-407, filed on December 15, 1999, by Special Trial Judge Couvillion, reviewed and adopted by Judge Dawson, and reviewed and approved by former Chief Judge Cohen." *Id.* at 314a-315a.

4. Ballard, Kanter, and Lisle immediately filed petitions for mandamus in the Eleventh, Seventh, and Fifth Circuits, respectively, seeking an order directing the Tax Court to provide them with a copy of the "original" report prepared by STJ Couvillion. The petitions for writs of mandamus were denied. *In re Ballard*, No. 00-14762-H (11th Cir. Oct. 23, 2000); *In re Investment Research Ass'ns*, No. 00-3369 (7th Cir. Dec. 15, 2000); *In re Estate of Lisle*, No. 00-60637 (5th Cir. Sept. 18, 2000).

Ballard, Kanter,[3] and Lisle subsequently filed appeals in the Eleventh, Seventh, and Fifth Circuits, respectively. All three courts of appeals concluded that the taxpayers are not entitled to any "original report" of STJ Couvillion. 03-184 Pet. App. 1a-18a; 03-1034 Pet. App. 1a-97a; *Estate of Lisle* v. *Commissioner*, 341 F.3d 364 (5th Cir. 2003).

a. **No. 03-184.** The Eleventh Circuit, considering Ballard's appeal, affirmed the Tax Court's decision in its entirety. 03-184 Pet. App. 1a-17a. With respect to Ballard's argument that the Tax Court unconstitutionally withheld "the findings of the [STJ]" from the parties, *id.* at 2a, the court of appeals concluded that the argument was incorrectly "premised upon the assertion that the underlying report adopted by the Tax Court is not, in fact, [STJ] Couvillion's report." *Id.* at 9a. In the Eleventh Circuit's view, the record belied that assumption as it "clearly reveals that the report adopted by the Tax Court is [STJ] Couvillion's report." *Ibid.*

Even if the STJ had initially filed a report with the Chief Judge that differed from the final report adopted by the Tax Court, non-disclosure of the initial report would "not give rise to due process concern." 03-184 Pet. App. 9a. The court reasoned that:

> [T]here is nothing unusual about judges conferring with one another about cases assigned to them. These conferences are an essential part of the judicial process when, by statute, more than one judge is charged with the responsibility of deciding the case. And, as a result of such conferences, judges sometimes change their original position or thoughts. Whether Special Trial Judge Couvillion prepared drafts of his report or subsequently changed his opinion entirely is without import insofar as

[3] Kanter died on October 31, 2001, and his estate has been substituted as petitioner in his case. 03-1034 Pet. App. 1a.

> our analysis of the alleged due process violation pertaining to the application of Rule 183 is concerned. Despite the invitation, this court will simply not interfere with another court's deliberative process.

Id. at 9a-10a. With respect to Ballard's challenges to the sufficiency of the evidence, the court of appeals held that "[t]he record supports" the imposition of taxes and a fraud penalty for the kickbacks. *Id.* at 14a.

b. **No. 03-1034.** The Seventh Circuit similarly affirmed the decision of the Tax Court with respect to Kanter. 03-1034 Pet. App. 1a-70a. The court of appeals rejected the argument that the "STJ's original report must be made a part of the record on appeal" in order to "determine whether the appropriate degree of deference had been paid to it by the Tax Court judge." *Id.* at 6a. In the Seventh Circuit's view, the argument was "immaterial" because "the underlying report adopted by the Tax Court was in fact Special Trial Judge Couvillion's." *Id.* at 7a. As a result, "[a]ny differing preliminary recommendations [by the STJ]—if they ever existed—would no longer be constitutionally relevant because the STJ has abandoned them." *Id.* at 13a.

Considering Kanter's claim that the judicial deliberations of the Tax Court were "quasi-collaborative" such that "an STJ's initial findings are malleable," the court of appeals concluded that such a system "would not offend our notions of fundamental fairness, nor would due process require the inclusion of the report in the appellate record to preserve the fairness of our review." 03-1034 Pet. App. 7a. Rather, "Congress intended STJ reports to be treated as preliminary findings comprising part of the Tax Court's internal deliberative process." *Id.* at 9a. Turning to the merits, the court of appeals concluded that the Tax Court's findings were not clearly erroneous and affirmed its legal conclusions.

Judge Cudahy concurred in part and dissented in part. 03-1034 Pet. App. 70a-97a. Judge Cudahy read the record to

support "the notion that the Tax Court engages in a quasi-collaborative process of review of the STJ's report from which a new and frequently different STJ's opinion emerges to be adopted and agreed with by the Tax Court." *Id.* at 74a. Although agreeing that such a collaborative procedure does not violate Tax Court Rule 183, see *id.* at 79a-80a, Judge Cudahy opined that such a process violates due process because it deprives the parties of "meaningful appellate review," *id.* at 96a, namely a determination of whether the Tax Court properly deferred to the STJ's credibility findings. *Id.* at 88a-97a.

c. Although its decision is not before the Court, the Fifth Circuit in *Estate of Lisle* v. *Commissioner*, 341 F.3d 364, 384 (2003), also concluded that "application of Rule 183 in this case did not violate Appellants' due process rights" based on "the reasoning of the Seventh and Eleventh Circuits." On the merits of Lisle's claim, the court of appeals concluded that the Commissioner had not carried his burden of establishing fraud with respect to Lisle and reversed the fraud penalties assessed by the Tax Court. *Id.* at 385.

SUMMARY OF ARGUMENT

I. A. Petitioners' primary contentions—that disclosure of the STJ's report is constitutionally and statutorily mandated in order to permit full appellate review and to ensure that the Tax Court has reviewed the STJ's recommended findings under a deferential standard—are not properly presented in these cases. STJ Couvillion's final report was adopted in full by the Tax Court, disclosed to the parties, and included in the record of this case. Accordingly, this case does not present any question concerning the proper degree of deference to be given an STJ's recommendations, nor does it present the question whether disclosure of reports reflecting an STJ's final recommendations is required. Rather, the only question is whether disclosure of an "original" report that was filed with the Chief Judge and later abandoned by

the STJ is required by the Due Process Clause or federal statute. It is not.

B. It is well settled that disclosure of a judge's deliberative processes is shielded from discovery by the parties. Petitioners attempt to divine some special reason for disclosing STJ Couvillion's deliberative process by asserting that the STJ was improperly influenced, but that claim lacks evidentiary support. Indeed, because this Court presumes that judges do not engage in misconduct, petitioners cannot be permitted to probe the STJ's deliberative process in the hope of discovering improper conduct.

Petitioners could gain nothing from mere disclosure of any "original" STJ report, because, as the findings below make clear, the published report accurately reflects the STJ's final recommended disposition of the case. Any differences between that final report and an "original" recommendation —like differences between a draft and final opinion—would not demonstrate improper influence or a failure to defer to the STJ's recommendations, but would presumptively be the result of the STJ's legitimate reevaluation of the case. Petitioners could not hope to substantiate their allegations of improper influence without still further intrusive discovery such as depositions of the judges involved, a result that is barred by precedent.

II. A. Even if presented in this case, petitioners' disclosure arguments would fail. Non-disclosure of the STJ's report does not preclude effective appellate review, because an STJ does not function as a trial court judge whose factual recommendations must be accepted on appeal absent "clear error." To the contrary, in cases such as this, STJs are prohibited by statute from functioning as original finders of fact.

The drafting history of Tax Court Rule 183 demonstrates that Rule 183 was designed to eliminate disclosure and appellate-style review of STJ reports. The "due regard" and

"presumed to be correct" language on which petitioners rely does not give rise to an enforceable right to appellate review, but rather guides the judges of the Tax Court in a way that reflects that the STJ had the opportunity to hear witnesses. Indeed, that language was added as part of an amendment intended to *expand* the Tax Court's options with respect to STJ reports, not limit its discretion over them.

B. The Tax Court's procedures comport with due process. This Court has held that tax disputes involve "public rights," and thus the full panoply of Article III protections is not required here. Nor is the Tax Court's non-disclosure practice unique, as petitioners mistakenly contend. Indeed, Congress has long mandated a similar practice with respect to decisions of regular Tax Court judges that are subject to full court review. Similarly, agency boards of contract appeals generally do not disclose the initial proposed dispositions of presiding judges who actually receive evidence.

In any event, mere novelty would not render the Tax Court's rules unconstitutional. The available evidence suggests that the Tax Court eliminated its disclosure requirement in 1984 to unify the court's decisional process and accommodate a tremendous influx of tax-shelter cases in the mid-1980s. Due process does not foreclose such procedural innovations.

C. Disclosure of the STJ's credibility assessments is unnecessary to prevent the Tax Court from rejecting those assessments "without seeing and hearing the witness" in violation of *United States* v. *Raddatz*, 447 U.S. 667, 681 n.7 (1980). In noncriminal, administrative cases, this Court has rejected claims that due process requires a non-Article III decisional authority to defer to a hearing officer's factual determinations or hear evidence firsthand. In any event, Tax Court Rule 183 contains the sorts of safeguards identified in *Raddatz* as sufficient to permit de novo review of a hearing examiner's credibility assessments.

D. The Tax Court's rules are not invalid under *Mathews* v. *Eldridge*, 424 U.S. 319 (1976). Petitioners have no legitimate interest in the disclosure of internal judicial deliberations, and petitioners' broader interest in the fair adjudication of their claims is amply protected by the procedural protections afforded. Any interest in disclosure would not outweigh the government's substantial interests in ensuring considered and confidential judicial decisionmaking and promoting expeditious resolution of tax cases.

III. The Internal Revenue Code does not compel disclosure of STJ reports. The appellate review provision, 26 U.S.C. 7482(a)(1), merely provides that Tax Court decisions are not entitled to any special deference, but are reviewed in the same manner as district court decisions. With respect to the Code's disclosure provisions, the Tax Court is required to publish an STJ report to the extent the court adopts the report's findings of fact and conclusions of law, see 26 U.S.C. 7459(b), 7461, but the provisions, by their terms, require no further disclosure.

ARGUMENT

I. PETITIONERS' CHALLENGES TO THE TAX COURT'S PRACTICES ARE NOT PROPERLY PRESENTED IN THESE CASES

A. The STJ's Recommended Findings Were Not Reversed Or Set Aside, But Were Instead Adopted And Disclosed In The Tax Court's Decision

Petitioners' primary challenges to the decisions below rest on the premise that disclosure of the STJ's "original" report is necessary to permit meaningful appellate review and to determine whether the Tax Court judge gave proper deference to the STJ's recommended findings. According to petitioners, the Tax Court "revers[ed] critical findings of fact, including credibility judgments, of the judge who had tried the case" (03-1034 Br. 1), but by preserving the confidential-

ity of its decisional process the Tax Court has made it "impossible for any reviewing Article III court to determine if" the Tax Court judge "did indeed give 'due regard' to" the STJ's recommendation (03-184 Br. 19).

The first, and most basic, flaw in petitioners' arguments is that they ignore the actions actually taken by the Tax Court. As we explained at the certiorari stage (03-184 Br. in Opp. 13; 03-1034 Br. in Opp. 12-13, 17), the findings of the Tax Court, affirmed on appeal by three appellate courts, conclusively establish that the Tax Court *accepted* the recommendations of the STJ, *adopted* his final report, and disclosed it by publishing it as the opinion of the court. See 03-184 Pet. App. 33a-306a. Thus, this case does not properly present the questions of what deference, if any, the Tax Court should give an STJ's recommendations before *rejecting* them or whether disclosure of an STJ's report is necessary to permit appellate review of a Tax Court judge's *rejection* of such a report. Resolution of those questions must "await a day when the issue[s] [are] posed less abstractly." *The Monrosa* v. *Carbon Black, Inc.*, 359 U.S. 180, 184 (1959).

It is beyond dispute that the Tax Court's opinion contains an accurate and full reproduction of the final STJ report reflecting the STJ's final recommendations. An order in the record signed by Chief Judge Wells, Judge Dawson, *and* STJ Couvillion provides that the Tax Court "*adopted* the findings of fact and opinion of Special Trial Judge Couvillion" and that "[t]he *only* official Memorandum Findings of Fact and Opinion" in the case was the report "filed on December 15, 1999, by Special Trial Judge Couvillion, reviewed and *adopted* by Judge Dawson, and reviewed and *approved* by former Chief Judge Cohen." *Id.* at 314a-315a (emphasis added). The order further explains that:

> Judge Dawson states and Special Trial Judge Couvillion agrees, that, after a meticulous and time-consuming review of the complex record in these cases, Judge Dawson adopted the findings of fact and opinion of Special Trial Judge Couvillion, that Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and that Judge Dawson gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses.

Id. at 315a.

Consistent with this order, the courts of appeals *uniformly* concluded that the report attributed to STJ Couvillion in the Tax Court's opinion is his report and that its presence in the record disposed of petitioners' claims. 03-1034 Pet. App. 7a ("[W]e accept as true the Tax Court's statement that the underlying report adopted by the Tax Court was in fact Special Trial Judge Couvillion's. This renders moot all of Kanter's arguments.") (internal citations omitted); 03-184 Pet. App. 9a ("[C]ontrary to Petitioners-Appellants' assertions, the record as presented to us clearly reveals that the report adopted by the Tax Court is Special Trial Judge Couvillion's report."); *Estate of Lisle* v. *Commissioner*, 341 F.3d 364, 384 (5th Cir. 2003) (adopting this reasoning).

The express statement by STJ Couvillion and Judge Dawson that the STJ's ultimate recommended findings were adopted by the Tax Court compels rejection of petitioners' repeated claims that the STJ's "report remains secret to this day—even from this Court" (03-184 Br. 9), and that the "record fails to reflect whether the Tax Court modified or reversed its trial judge's findings" (03-1034 Br. 38). Equally baseless is the claim (03-1034 Br. 1) that the government has conceded that the STJ's findings were "revers[ed]" by the Tax Court judge. The government has consistently argued that the statement by STJ Couvillion, Judge Dawson and Chief Judge Wells refutes that contention. See 03-1034 Resp. Br. in Opp. 12; 03-184 Resp. Br. in Opp. 13 & n.3.

B. Petitioners' Claims Thus Reduce To An Impermissible Attempt To Compel Disclosure Of The Tax Court's Internal Deliberative Processes

Petitioners' request for the "original STJ report" thus boils down to a claim for any initial report that the STJ submitted to the Chief Judge of the Tax Court but later abandoned in favor of the "final" report published in the record. That request should be refused by this Court. Even assuming that such an "original" report was submitted by STJ Couvillion, that report would reflect, not his ultimate decision, but a step in his confidential decisional process.

It is well settled that litigants are not entitled to compel disclosure of a judge's or agency's pre-decisional deliberative process. *See, e.g., Fayerweather* v. *Ritch*, 195 U.S. 276, 306-308 (1904); *Chicago, Burlington & Quincy Ry.* v. *Babcock*, 204 U.S. 585, 593 (1907). See also *In re Cook*, 49 F.3d 263, 265-266 (7th Cir. 1995) ("federal judges speak through their opinions"; "[i]nquiry beneath the surface of a judge's opinion is forbidden"); *Goetz* v. *Crosson*, 41 F.3d 800, 805 (2d Cir. 1994), cert. denied, 516 U.S. 821 (1995) ("[t]he inner workings of administrative decision making processes are almost never subject to discovery. * * * Clearly, the inner workings of decision making by courts are kept in even greater confidence."); *United States* v. *Crouch*, 566 F.2d 1311, 1316 (5th Cir. 1978) (same).

This Court reaffirmed that principle in *United States* v. *Morgan*, 313 U.S. 409, 417-422 (1941) (*Morgan IV*), which involved a challenge to a rate determination by the Secretary of Agriculture. In the district court, the Secretary had been deposed and made to explain "the process by which he reached the conclusions of his order" so that the court could evaluate whether the Secretary had conducted a fair hearing. *Id.* at 422. In affirming the Secretary's determination, this Court held that "the Secretary should never have been subjected to this examination." *Ibid.* The Court explained,

"it [is] not the function of the court to probe the mental processes" of administrative or judicial decisional authorities. *Ibid.* Rather, "[s]uch an examination of a judge would be destructive of judicial responsibility. * * * Just as a judge cannot be subjected to such a scrutiny, so the integrity of the administrative process must be equally respected." *Ibid.* (internal citations omitted).

Petitioners' suggestion (03-184 Br. 35-43) that STJ Couvillion's deliberative process should nonetheless be disclosed to determine whether his findings were coerced by or the result of improper collaboration with Judge Dawson represents an impermissible intrusion into the court's decision-making process.

1. Petitioners' Claim Of Improper Influence On STJ Couvillion Lacks Factual Support

Petitioners' allegation of improper influence on STJ Couvillion rests on the uniform acceptance of STJ reports by Tax Court judges (03-1034 Br. 8-10, 15-16, 21; 03-184 Br. 7-10, 16-17, 19 & n.14), a hearsay affidavit from petitioners' counsel about alleged "revisions" to STJ Couvillion's report (03-1034 Br. 6a), and surmise (03-184 Br. 9, 41-42) premised on the STJ hiring process. None of those assertions provides a sufficient basis for requiring disclosure of the Tax Court's internal deliberative process.

The tendency of STJs and Tax Court judges to agree is not probative of improper influence. Such agreement was evident prior to 1983, when under then-Tax Court Rule 182, STJ reports were served on the parties, who could then file exceptions. See Tax Ct. R. 182(b) (1974). From 1976 to 1983, for example, there were only *six* cases, out of approximately 680 decisions, in which the Tax Court did not adopt the opinion of the STJ, and only *one* case in which the Tax Court

"reversed" the STJ.[4] Thus, even when the STJ's report was available to the parties prior to the Tax Court's review, full adoption of STJ recommendations was the rule, not the exception.

The Declaration of Randall G. Dick (03-1034 Br. App. 5a-7a) also fails to demonstrate misconduct. It states only that petitioners' counsel heard that "changes to judge Couvillion's findings relating to credibility and fraud were made by Judge Dawson" in a way that constituted an "outright

[4] See *Kansas City S. Ry.* v. *Commissioner*, 76 T.C. 1067 (1981); *Narver* v. *Commissioner*, 75 T.C. 53 (1980); *Hilton* v. *Commissioner*, 74 T.C. 305 (1980); *La Fargue* v. *Commissioner*, 73 T.C. 40 (1979); *C. Blake McDowell, Inc.* v. *Commissioner*, 67 T.C. 1043 (1977), vacated and remanded, 576 F.2d 718 (6th Cir.), on remand, 71 T.C. 71 (1978), aff'd, 652 F.2d 606 (6th Cir. 1980). In 14 (out of approximately 680) other cases, the Tax Court adopted the opinion of the STJ with modifications that were, in most instances, described as "minor." See *Ocean Sands Holding Corp.* v. *Commissioner*, 41 T.C.M. (CCH) 1, 2 (1980) ("minor modifications"), aff'd, 701 F.2d 163 (4th Cir.) (Table), cert. denied, 464 U.S. 827 (1983); *Taylor* v. *Commissioner*, 41 T.C.M. (CCH) 539, 539 (1980) ("some modifications"); *Perrett* v. *Commissioner*, 74 T.C. 111, 111 (1980) ("minor modifications"), aff'd, 679 F.2d 900 (9th Cir. 1982) (Table); *Karme* v. *Commissioner*, 73 T.C.M. 1163, 1163 (1980) ("minor modifications"), aff'd, 673 F.2d 1062 (9th Cir. 1982); *Freidus* v. *Commissioner*, 39 T.C.M. (CCH) 740, 740, (1979) ("some amendments"); *McKinley* v. *Commissioner*, 37 T.C.M. (CCH) 1769, 1769 (1978) ("minor modifications"); *Estate of Thurner* v. *Commissioner*, 37 T.C.M. (CCH) 981, 982 (1978) ("modified in minor respects"); *Ward* v. *Commissioner*, 37 T.C.M. (CCH) 928, 928 (1978) ("minor changes"); *Dante* v. *Commissioner*, 37 T.C.M. (CCH) 556, 556 (1978) ("minor modifications"); *Estate of Marcello* v. *Commissioner*, 36 T.C.M. (CCH) 1408, 1409 (1977) ("minor changes"); *Jacqueline, Inc.* v. *Commissioner*, 36 T.C.M. (CCH) 1363, 1363 (1977) ("[s]ome modifications"), modified, 37 T.C.M. (CCH) 937 (1978); *Ducar* v. *Commissioner*, 36 T.C.M. (CCH) 1278, 1279 (1977) ("minor changes"); *Graham* v. *Commissioner*, 35 T.C.M. (CCH) 1315, 1316 (1976) ("minor modifications"); *Louisville & Nashville R.R.* v. *Commissioner*, 66 T.C. 962, 963 (1976) ("some amendments"), aff'd in part, rev'd in part and remanded, 641 F.2d 435 (6th Cir. 1981).

rejection of credibility findings" initially proposed by the STJ. *Id.* at 6a. Even assuming arguendo the truth of those hearsay statements, whether Judge Dawson suggested "revisions" is of no moment so long as STJ Couvillion ultimately agreed with and adopted those changes in his report. The order signed by, *inter alia*, STJ Couvillion should end any speculation about whether his report might have been "revised" without his consent, because it flatly states that his report was adopted by Judge Dawson. 03-184 Pet. App. 315a.

Finally, petitioners cannot raise the specter of impropriety by claiming that STJs are hired and fired by regular Tax Court judges (03-184 Br. 9, 41-42). STJs *cannot* be hired or fired by the regular judges to whom they report, but are salaried, full-time employees appointed solely by the Chief Judge. See 26 U.S.C. 7443A(a); Tax Ct. R. 180. There is nothing in the record, or indeed the entire history of the Tax Court, to suggest that STJ Couvillion (or any other STJ) has ever been threatened with termination or otherwise improperly coerced into adopting a view of the case advanced by the regular Tax Court judge but contrary to his own views. Nor is there any basis for concluding that any STJ would acquiesce in the face of such conduct.

2. As A Matter Of Law, Judicial Misconduct Will Not Be Presumed

Beyond those factual deficiencies, petitioners' suggestion of misconduct in the Tax Court's deliberative process is legally flawed for two reasons. First, petitioners' attempt to require disclosure of the Tax Court's internal deliberative process in order to *discover* whether any improprieties have occurred turns the standard assumption about judicial conduct on its head. Courts should not be "inclined to assume" nefarious conduct on the part of judges, but should accept a judge's claim that he has performed his judicial responsibilities absent "proof" by a challenging party to the contrary.

Freytag v. *Commissioner*, 501 U.S. 868, 872 n.2 (1991). Cf. *Erhard* v. *Commissioner*, 46 F.3d 1470, 1476 (9th Cir. 1995); *Richardson* v. *Town of Eastover*, 922 F.2d 1152, 1161 (4th Cir. 1991). Thus, where a judge denies the factual basis for a recusal claim, the denial ends the matter. *E.g.*, *Sao Paulo State of Federative Republic of Brazil* v. *American Tobacco Co.*, 535 U.S. 229, 233 (2002) (crediting judge's rendition); *In re Brooks*, No. 03-5047, 2004 WL 2032521, at *6 (D.C. Cir. Sept. 14, 2004) (same). Similarly, where a judge's partiality is questioned, the claim is examined "in light of the facts" set forth in the judge's report, "and not as they were surmised or reported" erroneously by those not present. *Cheney* v. *U.S. Dist. Court*, 124 S. Ct. 1391, 1392 (2004) (Scalia, J.).

Accordingly, the proper starting point in this case is the order signed by STJ Couvillion, Judge Dawson and the Chief Judge Wells. That order states that Judge Dawson "adopted the findings of fact and opinion of Special Trial Judge Couvillion" and gave "due regard" to the STJ's recommendations. 03-1034 Pet. App. 102a; 03-184 Pet. App. 315a. If those statements were incorrect, the STJ would "say so," and neither he nor Chief Judge Wells nor Judge Dawson would have signed the order. 03-1034 Pet. App. 13a. For the same reason, the numerous Tax Court opinions that, like the decision below, begin "the Court agrees with and adopts the opinion of the Special Trial Judge, which is set forth below," should be taken at face value.

Second, to the extent petitioners' claim is merely that STJs and Tax Court judges collaborate in a way that allows a Tax Court judge to influence an STJ recommendation before the STJ finalizes it, their claim lacks legal merit. There is simply no legal prohibition against judges exchanging ideas, or even vigorously lobbying one another, in an attempt to influence the decision-making process. To the contrary, judges routinely "confer[] with one another about cases assigned to them," and sometimes change their minds about

a case as a result of those consultations. 03-1034 Pet. App. 13a-14a. Because "votes are not final until decisions are final; and decisions do not become final until they are released, accompanied by an explanation of the reasons for the result," the mere fact that "the exchange of draft opinions can and does change votes" does not violate due process. *Checkosky* v. *SEC*, 23 F.3d 452, 489-490 (D.C. Cir. 1994). While that kind of back and forth between judges is most familiar in the context of judges jointly hearing a case as a panel, nothing precludes such interchange between the STJ and a Tax Court judge in light of the particular structure of decisionmaking reflected in Rule 183. See pp. 24-29, *infra*.

The exchange of drafts and ideas between an STJ and a regular judge of the Tax Court similarly is not forbidden "ex parte" communication. See 03-184 Br. 9-10, 36-40. Indeed, the assertion is wrong by definition, because neither the Tax Court judge nor the STJ is a "party" in the case. See *Black's Law Dictionary* 597 (7th ed. 1999) (defining "ex parte" as "[d]one or made at the instance and for the benefit of one party only"). To be sure, where different employees of an agency perform investigatory, prosecutorial, and adjudicative responsibilities, those employees with investigative and prosecutorial duties will generally not have a role in the adjudicative process. See 5 U.S.C. 554(d)(2); *Morgan* v. *United States*, 304 U.S. 1, 19-20 (1938) (*Morgan II*). Tellingly, however, there is no such prohibition against confidential communications between an agency head, who serves as the final agency adjudicator, and a hearing examiner regarding a pending adjudicative matter. Congress expressly *exempted* such communications from the prohibition against prosecutorial contacts. 5 U.S.C. 554(d)(2)(C).

This Court acknowledged the practice of confidential communication between decisional authorities and hearing officers in *Morgan IV*. The parties challenging the Secretary of Agriculture's rate determination in that case

asserted *inter alia* that "the Secretary * * * conferred on several different occasions with the Examiner concerning the evidence and the findings to be made thereon out of the presence of appellee market agencies and their counsel," that the Examiner was "an employee dominated by the Secretary," and that the Secretary effectively "told the Trial Examiner which way the Secretary would like the case to go upon the merits." Br. for Appellees at 58, 109, 113, *United States* v. *Morgan*, 313 U.S. 409 (1941) (No. 640). The Court likewise noted that the Secretary had "held various conferences with the examiner who heard the evidence" (313 U.S. at 422), but stated that he had "dealt with the enormous record in a manner not unlike the practice of judges in similar situations." *Ibid.* The Court upheld the Secretary's decision, concluding that "[t]he record leaves no doubt that the Secretary * * * appropriately discharged [his] duty." *Id.* at 415.

3. Disclosure Of An "Original" Report Could Not Benefit Petitioners Absent Further Unacceptable Intrusions Into The Tax Court's Deliberative Process

Allowing petitioners to obtain access to an "original," but subsequently abandoned, STJ report would lead only to more demands for intrusion into the Tax Court's deliberative process. Mere disclosure of such an original report could not in itself provide any basis for granting petitioners relief from the judgment of the Tax Court, because the record is clear that STJ Couvillion's final recommendations regarding the disposition of this case are embodied *in toto* in the decision of the Tax Court. The Tax Court judge did not reverse, modify, or set aside those recommendations, and thus there would be nothing of relevance to be considered by the courts of appeals even if petitioners could establish that the STJ changed his views over the course of the deliberative process. That a judge changed his mind before adopting his

final view of a case is hardly grounds for setting aside a final judgment. Indeed, the courts below have *already held* that proof of such a change of mind would not invalidate the Tax Court's judgment; the mere disclosure of any abandoned "original" report would thus avail petitioners nothing. 03-184 Pet. App. 9a-10a ("Whether Special Trial Judge Couvillion prepared drafts of his report or subsequently changed his opinion is entirely without import."); 03-1034 Pet. App. 13a ("Any differing preliminary recommendations—if they ever existed—would no longer be constitutionally relevant because the STJ has abandoned them.").

In order to have any prospect of obtaining relief from the judgment of the Tax Court, therefore, petitioners could not be content with the mere disclosure of an "original" report. Instead, petitioners would have to pursue still further discovery in an effort to identify some evidentiary basis for their allegations that STJ Couvillion did not in fact agree with the findings set forth as his report in the decision of the Tax Court. In short, petitioners would need to reconstruct the entire internal deliberative process, presumably by requests to depose STJ Couvillion and Judge Dawson.

Far from being a requirement of due process, subjecting judges to examination to learn about their decisional process has never been countenanced by this Court. See *Morgan IV*, 313 U.S. at 422; *Fayerweather*, 195 U.S. at 306-307. The first step toward that examination should not be taken here. Petitioners' claims should be rejected—or the writs of certiorari should be dismissed as improvidently granted—because even a ruling in petitioners' favor on the questions presented could not change the final disposition below in the absence of still further, and patently impermissible, discovery of the Tax Court's internal deliberations.

II. THE TAX COURT'S PROCEDURES COMPORT WITH DUE PROCESS

Petitioners contend that non-disclosure of an "original" STJ report precludes effective appellate review, departs from historical and contemporary judicial practice in violation of due process, and violates *Mathews* v. *Eldridge*. Even if presented by this case, those arguments would lack merit.

A. Disclosure Of An "Original" STJ Report Is Unnecessary For Effective Appellate Review

Petitioners' arguments concerning effective appellate review assume that an STJ functions as a trial court judge whose factual recommendations must be accepted absent "clear error." Thus, petitioners claim, STJ reports must be disclosed so that the courts of appeals can consider whether the Tax Court properly applied the "clearly erroneous" standard of review in rejecting any findings recommended by the STJ. That argument fundamentally misunderstands the function and responsibilities of STJs.

1. The Tax Court Judge, Not The STJ, Determines Facts And Legal Conclusions

In cases such as this, tried pursuant to Section 7443A(b)(4) of the Internal Revenue Code, STJs are simply not authorized to function as trial court judges whose findings are reviewable only for clear error. By statute, STJs are precluded from entering the "decision of the Tax Court" as to either fact or law in proceedings of the type at issue here. See 26 U.S.C. 7443A(c). In *Freytag* v. *Commissioner*, 501 U.S. 868, 873-876 (1991), this Court settled the question, holding that STJs "ha[ve] no authority to decide a case assigned [to them] under subsection (b)(4)" of Section 7443A. *Id.* at 875 n.3. The "authority actually to decide those cases * * * is reserved *exclusively* for judges of the Tax Court." *Id.* at 874 (emphasis added).

Consistent with that statutory mandate, the Tax Court's rules confer decisional authority only on the regular judge of the Tax Court when a case is heard by an STJ under Section 7443A(b)(4). Rule 183(c) provides that the judge "may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions." Tax Ct. R. 183(c); see 26 U.S.C. 7443A(c). Thus, the only decision relevant for appellate review is the decision of the Tax Court. 26 U.S.C. 7443A(c), 7460(b); see 03-1034 Pet. App. 8a ("The Tax Court thus acts as the original finder of fact.").

2. The Tax Court Is Not Required By Its Rules To Review STJ Reports For Clear Error

Petitioners' contrary argument (e.g. 03-184 Br. 22-23, 31-32; 03-1034 Br. 4-5, 17-18, 19-20) derives from their misreading of Tax Court Rule 183(c) to require review of STJ reports under the "clear error" standard or a similarly deferential standard of review. As explained in Part I above, the standard-of-review issue is not presented in this case, because the record demonstrates that the Tax Court judge did not reverse or set aside, but instead accepted, the STJ's recommended findings. In any event, petitioners are mistaken; far from requiring clear-error review, current Tax Court Rule 183 eliminated any sort of appellate-style review from proceedings within the Tax Court.

The current Tax Court Rule 183(c), which was adopted in 1983, provides:

> The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may

> recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

Tax Ct. R. 183(c). In contrast, Rule 183's predecessor, Rule 182, had (since 1974) contained similar language concerning "due regard" and the presumed correctness of STJ reports, but also required STJs to "serve[]" their reports, "including" any "findings of fact and opinion," on the parties and provide the parties an opportunity to file briefs with the Tax Court setting forth their "exceptions" to the report, and to request argument on the issues so briefed. Tax Ct. R. 182(a), (b), (c) and (d) (1974). In 1983, the Tax Court amended the rule to its current form, "delet[ing]" "[t]he prior provisions for service of the Special Trial Judge's report on each party and for the filing of exceptions to that report." Tax Ct. R. 183 note (1984).

By altering its rules specifically to *eliminate* disclosure of and exceptions to STJ reports, the Tax Court has made plain that it does not contemplate any sort of appellate-style review of STJ reports. See *Freytag* v. *Commissioner*, 904 F.2d 1011, 1015 n.8 (5th Cir. 1990) (observing that rule change "confirm[ed] that the Tax Court's relationship with its special trial judges cannot be analogized to typical appellate review"), aff'd, 501 U.S. 868 (1991). Although Rule 183(c) continues to instruct Tax Court judges to give "due regard" to the "circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses," and "presume[]" STJ findings "to be correct," that language does not require review of STJ reports for clear error. Instead, it merely requires Tax Court judges "to be cognizant that the STJ had the opportunity to evaluate the credibility of witnesses." 03-1034 Pet. App. 8a. On this point, even the sole dissenting judge in the proceedings below

agreed. *Id.* at 75a (Cudahy, J., concurring in part and dissenting in part) ("Rule 183 imposes no requirement of disclosure or of clearly erroneous deference upon the Tax Court").

Ascribing a deeper meaning to the "due regard" and "presumed to be correct" language would not comport with the Tax Court note explaining the addition of that language in 1974. The note provides that the amendment was intended to *expand* the decisional authority of Tax Court judges with respect to STJ reports, stating that "[t]he decision of a case is made by a Judge, and the rule *expands* the alternatives available in reviewing the determinations of the commissioner as embodied in his report. The Judge, to whom the case is assigned, may take *any* action he deems appropriate for a proper disposition of the case, *even with respect to the commissioner's findings of fact*, although they are accorded special weight insofar as those findings are determined by the opportunity to hear and observe the witnesses." Tax Ct. R. 182(b) note (1974) (emphasis added).[5] Thus, notwithstanding the "due regard" and "presumed correct" language, the Tax Court intended to retain full decisional authority over cases under the new rule.

The Tax Court's own interpretation of its procedures bolsters that reading of Rule 183. In *Rosenbaum* v. *Commissioner*, 45 T.C.M. (CCH) 825, 827 (1983), the Tax Court was asked to consider whether it had given the deference required under former Rule 182 to an STJ report. The court

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[5] Petitioners argue (03-1034 Br. 31) that a reference in this note to "Court of Claims procedures" demonstrates the Tax Court's intent to review reports for clear error, as that was the existing practice of the Court of Claims when former Rule 182 was adopted. But the note, by its terms, does not suggest an intent to *duplicate* the Court of Claims' standards of review; it provides only that the Tax Court's procedures should be "*more comparable* to those which obtain in the Court of Claims." Tax Ct. R. 182 note (emphasis added).

observed that while its rules required it to give "due regard to the circumstance that the Special Trial Judge had the opportunity to see and evaluate the credibility of witnesses," "the presumptive correctness of the Special Trial Judge's report does not impair nor dilute our duty of bearing the ultimate responsibility for determining matters before us." *Ibid.*

Petitioners' reliance on *Stone* v. *Commissioner*, 865 F.2d 342 (D.C. Cir. 1989), rev'g *sub nom. Rosenbaum* v. *Commissioner*, 45 T.C.M. (CCH) 825, 827 (1983) (03-1034 Br. 7 n.2, 28-34; 03-184 Br. 17, 22, 27-28), for a contrary interpretation of the "due regard" language is misplaced.[6] In *Stone*, the D.C. Circuit held that the Tax Court was required under former Tax Court Rule 182 to review the recommended findings of STJs under a clearly erroneous standard. 865 F.2d at 345-347.

[6] Kanter errs in asserting (Br. 32) that the government has conceded the validity of the *Stone* decision. The government has long regarded *Stone* as wrongly decided in light of the D.C. Circuit's failure to defer to the Tax Court's interpretation of its own rule. See Resp. Br. at 19 n.10, *Freytag* v. *Commissioner*, *supra*. Indeed, shortly after *Stone* was decided, the government explained its view of the case as follows:

> the Tax Court has never retreated from the position it took in *Rosenbaum* that "the presumptive correctness of the Special Trial Judge's report does not impair nor dilute our duty of bearing the ultimate responsibility for determining matters before us." *Rosenbaum*, 45 T.C.M. (CCH) at 827. In accordance with that position, the Tax Court no longer furnishes litigants a copy of the special trial judge's report, nor does it invite the parties to file exceptions to the report. *Ibid.*; Pet. App. A8 n.8. As the court of appeals concluded, "this change in rules, in our view, confirms that the Tax Court's relationship with its special trial judges cannot be analogized to typical appellate review." *Ibid.* No court has held to the contrary since the change in the Tax Court's practice.

Ibid.

Given that *Stone* was decided under former Rule 182, which contained the service-and-objection requirement, it is inapposite here. By eliminating the service-and-objection procedures, the Tax Court has removed any ambiguity over whether STJs function like trial court judges subject to appellate-style review by Tax Court judges. *Freytag*, 904 F.2d at 1015 n.8. Thus, those courts considering the validity of *Stone* since the Tax Court adopted Rule 183(c) have uniformly concluded that it does not mandate review of STJ findings by the Tax Court for clear error. See *ibid.*; 03-1034 Pet. App. 8a-9a ("The Tax Court thus acts as the original finder of fact. * * * [T]he STJ's inability to decide cases limits the amount of deference that the Tax Court, as the original factfinder, must pay to those preliminary findings."); *id.* at 75a (Cudahy, J., concurring in part, dissenting in part) ("Rule 183 imposes no requirement of disclosure or of clearly erroneous deference upon the Tax Court."); accord *Estate of Lisle* v. *Commissioner*, 341 F.3d 364, 384 (5th Cir. 2003).[7]

[7] Even if the Court were to conclude that the 1983 amendment to Rule 183 is problematic because of tension between the non-disclosure rule and the "due regard" and "presumed to be correct" language, the proper remedy would not be to compel disclosure of "original" STJ reports. The Tax Court eliminated the practice of disclosing STJ reports, and the "due regard" and "presumed to be correct" language can be construed as internal direction to guide the Tax Court judges in considering STJ reports. But if that language were inherently to give rise to rights in the taxpayer, that language should give way to the Tax Court's clear intent to eliminate disclosure and briefing. Nothing in the Constitution or the Internal Revenue Code required the Tax Court to retain the provisions regarding deference to STJ recommendations. Thus, if the Tax Court's failure to delete the "due regard" and presumption language in 1983 cannot be reconciled with the court's non-disclosure rule, the proper result would be to invalidate the offending language in the rule, not to reject the Tax Court's clear policy decision to preserve the confidentiality of initial STJ reports. At the very least, a remand to the Tax Court would be required to permit that court to decide the question of severability that would be raised in those circumstances. Cf. *Davis* v. *Michigan Dep't of Treasury*,

B. The Tax Court's Practice Is Neither Unprecedented Nor Unjustified

Petitioners contend (03-1034 Br. 17, 23-24; 03-184 Br. 17, 43- 46) that disclosure of initial STJ reports is required by virtue of historical and contemporary judicial and administrative practice. *Ibid.* (citing *Honda Motor Co.* v. *Oberg*, 512 U.S. 415, 430 (1994)). Those contentions are incorrect.

As an initial matter, petitioners overlook the well-established principle that the procedures followed in the Article III context generally do not define the proper benchmark for evaluating tax proceedings, because such proceedings do not require the full complement of procedural safeguards that may be necessary elsewhere. At common law, tax cases were resolved in a branch of the "court of exchequer" and were not "judicial controversies * * * according to the ordinary course of the common law or equity." *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U.S. (18 How.) 272, 282 (1855). The Exchequer was a "department" in which "a court of revenue [was] held before the Treasurer," and which was "probably the nearest approach to a body of administrative law that the English legal system has ever known; and the court of Exchequer, sitting as a court of Revenue, is the nearest approach to an administrative court." 1 W. Holdsworth, *A History of English Law* 231, 238, 239 (1926). See A. Carter, *A History of the English Courts* 51 (7th ed. 1944).

Indeed, this Court has concluded that tax cases are "public rights" cases, which "congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper." *Crowell* v. *Benson*, 285 U.S. 22, 50 (1932) (quoting *Murray's Lessee*, 59 U.S. (18 How.) at 284); *Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*,

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489 U.S. 803, 818 (1989); *Atchison, Topeka & Santa Fe Ry.* v. *Wichita Bd. of Trade*, 412 U.S. 800, 822 (1973).

458 U.S. 50, 68, 70 n.23 (1982) (as to matters involving "public rights," a category of cases that includes "taxation," Congress "would be free to commit such matters completely to nonjudicial executive determination"); *Ex parte Bakelite Corp.*, 279 U.S. 438, 451 (1929). Accordingly, it has long been recognized that tax disputes may be subject to unique procedures that might otherwise be impermissible in the Article III context. See *Murray's Lessee*, 59 U.S. (18 How.) at 284. That principle follows from the fact that "the very existence of government depends upon the prompt collection of the revenues." *G. M. Leasing Corp.* v. *United States*, 429 U.S. 338, 352 n.18 (1977).

In any event, petitioners are wrong in characterizing the Tax Court's practice as unique or aberrational. Most saliently, there is a direct *statutory* analog to the Tax Court's STJ practice: the non-disclosure of a regular Tax Court judge's opinion when a case is reviewed by the full Tax Court. From the earliest days of the Tax Court's predecessor, Congress has provided that initial reports reflecting the proposed disposition of a case were subject to review by the full court, and when that option is exercised Congress has *required* the exclusion of the "original" report from the record. See Revenue Act of 1928, ch. 852, § 601, 45 Stat. 871. That historical practice continues today with Section 7460(b) of the Internal Revenue Code, which directs that, in cases of full court review, the report of the regular judge "shall not be a part of the record." 26 U.S.C. 7460(b); see *Estate of Varian* v. *Commissioner*, 396 F.2d 753, 754-755 (9th Cir.) (rejecting argument that due process requires inclusion of the regular judge's opinion in the record), cert. denied, 393 U.S. 962 (1968); *Heim* v. *Commissioner*, 251 F.2d 44, 45-46 (8th Cir. 1958) (same).

Outside the tax context, the numerous boards of contract appeals established by various agencies similarly do not require disclosure of initial reports prepared by presiding

judges and submitted to other judges for final decision. Under the Contract Disputes Act, 41 U.S.C. 601 *et seq.*, administrative agencies are authorized to establish boards of contract appeals to resolve certain contract disputes between the agency and contractors. See 41 U.S.C. 607. Such boards are typically comprised of a chairperson and several administrative judges. The chairperson typically assigns a case to a panel of administrative judges, one of whom is designated the "presiding judge" responsible for conducting any evidentiary hearing. The presiding judge's initial proposed decision and credibility assessments are not disclosed to the parties or reviewed only for clear error by the other panel members. Only the panel's final decision is served on the parties and included in the record.[8] As with STJ reports, the recommendations of a presiding judge who hears the evidence firsthand can be rejected by the other judges on the panel, who review only the record and the presiding judge's proposed disposition. *E.g. Lockheed Martin Tactical Def. Sys., Inc.*, Contract No. N00039-86-C-0452, 2000 WL 626879, at n.1 (Armed Serv. Bd. Cont. App. May 3, 2000) (rejecting credibility assessments of presiding judge); *Appeal of Ash Anlagen-Und Sanierungstechnik GMBH*, Contract No. DAJA76-87-C-0467, 2003 WL 22230677 (Armed Serv. Bd. Cont. App. Sept. 24, 2003) (same); *Smith & Oby Co.* v. *General Servs. Admin.*, No. 15336, 2003 WL 22100648 (Gen. Servs. Admin. Bd. Cont. App. Sept. 5, 2003) (retirement of presiding judge prior to decision). That system of non-disclosure and non-deference to the hearing officer's

[8] *E.g.*, Gen. Servs. Admin. Bd. Cont. App. R. 101(e) ("Each case will be assigned to a panel consisting of three judges, with one member designated as the panel chairman. * * * The panel chairman is responsible for processing the case, including scheduling and conducting proceedings and hearings."), 122(c) (the "Board" determines "the credibility to be accorded to witnesses"), 129 (parties provided with only decision of board). See also 7 C.F.R. 24.2, 24.3, 24.21; 38 C.F.R. 1.781, 1.783.

recommendations is accepted practice because the full panel, not the presiding judge, is understood to render decision. See *Bill J. Copeland*, No. 2003-124-R, 2003 WL 1740503 (Dep't of Agriculture Bd. Cont. App. Feb. 20, 2003) (rejecting request for rehearing after retirement of presiding judge on the ground that "[a] presiding judge has no greater say in the outcome of an appeal than the other members"); *Charles G. Williams Constr.* v. *White*, 326 F.3d 1376, 1381 (Fed. Cir. 2003) (rejecting argument that presiding judge is "particularly well qualified" to evaluate credibility as sole officer hearing witnesses).

The counter-examples offered by petitioners (03-1034 Br. 23- 24; 03-184 Br. 39-40), such as the procedures governing ALJs and magistrate judges, are inapposite. In the first place, that Congress has chosen to mandate disclosure of initial recommended decisions in those contexts is no basis for extending the same requirement to other settings. By expressly precluding disclosure of "reviewed" decisions of Tax Court judges (26 U.S.C. 7460(b)), Congress has signaled that it sees no constitutional objections to proceeding in that manner. In the same way, by granting exclusive rulemaking authority to the Tax Court (26 U.S.C. 7443A(a), 7453), Congress has empowered that court, at a minimum, to choose between the two ways of treating initial opinions that Congress has found advisable in different contexts.

Petitioners' examples are, in any event, inapt. By statute, an ALJ's recommended decision *automatically* "becomes the decision of the agency" unless a party objects, without any review whatsoever by the ultimate agency decisionmaker. 5 U.S.C. 557(b).[9] Given that fact, it is unsurprising that Con-

[9] Unless a party interposes an objection, the factual recommendations of a magistrate judge can automatically be made the findings of the court without further review by the district judge. See 28 U.S.C. 636(b)(1)(A); *Thomas* v. *Arn*, 474 U.S. 140, 148-152 (1985); see also Fed. R. Civ. P. 53(g)(3) (special masters); *Kentucky* v. *Indiana*, 474 U.S. 1, 1 (1985) ("The

gress has required that ALJ decisions be disclosed, thereby giving parties the opportunity to invoke review by the final agency decisionmaker. See 5 U.S.C. 557(c). STJ reports do not operate in the same manner, because Congress has statutorily *precluded* STJs from functioning as decisionmakers in this context. See 26 U.S.C. 7443A(b)(4) and (c); *Freytag*, 501 U.S. at 875 n.3.[10]

Even if the Tax Court's practices lacked historical pedigree or modern analog, they would not be unconstitutional simply by virtue of their supposed novelty. Courts often adopt procedures without historical precedent to respond to the unique demands of the day, such as class action suits, multi-district litigation, and even the merger of courts of equity and courts of law. The Tax Court itself is a relatively modern innovation that responded to the perceived need for a tribunal in which taxpayers could quickly and easily settle their disputes before paying a disputed tax. The Tax Court's practices are a reflection of its special role as an informal, nationwide tribunal for the efficient resolution of taxpayer claims.

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parties having waived the right to file Exceptions, the Report [of the Special Master] is adopted."). In any event, the magistrate and special-master examples are inapposite because they arise in the Article III context, where the Constitution imposes constraints on the utilization of adjunct decisionmakers.

[10] Petitioners' reliance on *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 493 (1951), for the proposition that disclosure of a hearing examiner's report is necessary "to accurate appellate adjudication" (03-1034 Br. 35; see 03-184 Br. 25) is misplaced. The statutes at issue in *Universal Camera* required that the hearing examiner include his report in the record, and "the plain language of the statutes direct[ed] a reviewing court to determine the substantiality of evidence on the record including the examiner's report." *Universal Camera*, 340 U.S. at 493 (citing the Taft-Hartley Act, ch. 120, § 10(c), 61 Stat. 148, and the Administrative Procedure Act, ch. 324, § 8(b), 60 Stat. 242; see 5 U.S.C. 557(c)). No such statutes apply here.

As one commentator on Rule 183(c) has observed, the Tax Court is unique in that it is a single nationwide court that "speaks with a single voice" while expeditiously resolving cases among 19 judges who still ride circuit. A. Madison, *Revisiting Access to the Tax Court's Deliberative Process*, Tax Notes, May 10, 2004, at 751. Imposing an appellate-style review process on the court would add an unnecessary layer of decision to the detriment of the quick and easy resolution of Tax Court proceedings. *Ibid.*

Indeed, while the Tax Court did not set forth its rationale for amending its rules in 1984 to preserve the confidentiality of STJ reports, the events of the time strongly suggest that the amendment was necessary to the expeditious resolution of cases. Congress made major revisions to the Internal Revenue Code that increased taxpayer liability for abusive tax shelters, and in early 1983, then-Tax Court Chief Judge Designate Tannenwald warned that he "anticipated increases in the number of shelter and tax protester cases * * * from the newly enacted provisions of the Internal Revenue Code." *Treasury, Postal Service, and General Government Appropriations for Fiscal Year 1984: Hearings Before the Subcomm. of the House Comm. on Appropriations*, 98th Cong., 1st Sess. Pt. 4, at 8 (1983) (FY 1984 Hearings). In fact, the Tax Court was quickly flooded with tax shelter petitions; the number of cases filed with the court doubled from 1980 to 1985, increasing nearly 50% from fiscal years 1982 to 1985 alone. See *Treasury, Postal Service, and General Government Appropriations for Fiscal Year 1987: Hearings Before the Subcomm. of the House Comm. on Appropriations*, 99th Cong., 2d Sess. Pt. 4, at 355, 380 (1986). The court's backlog of pending cases increased at a similar rate: between fiscal years 1982 and 1985, the number of authorized Tax Court judges remained steady at 19, while the number of pending cases increased by more than 38%. *Id.* at 361; see FY 1984 Hearings at 49; 26 U.S.C. 7443.

Faced with that anticipated flood of litigation, the Tax Court removed the disclosure and objection provisions when it promulgated Rule 183, and eliminated the unnecessary layer of additional briefing and argument the court had previously permitted.

This reading of history is supported by a similar amendment to the Tax Court's rules that occurred only a few years before the disclosure provisions were eliminated entirely in 1984. In 1976, the Tax Court eliminated the service-and-objection requirement in STJ cases that did not fall within the court's "small tax case" docket but involved amounts under $2500, at a time when it was facing a surge in such cases. The court explained that the increasing "number of new cases filed in the United States Tax Court * * * involving deficiencies under $2,500" required it "to make changes in the present practices of the Court in order to dispose of pending cases more promptly and efficiently." Tax Ct. General Order No. 5, at 1 (Oct. 1, 1976). To that end, in all such cases the court permitted STJs to submit a report for decision directly to the Chief Judge of the Tax Court, without disclosure of the report to the parties and without an opportunity for the parties to object to the report. *Id.* at 1-2. In the court's view, it was "clearly impracticable and undesirable to follow the post-trial procedures" regarding STJ reports in those cases. *Id.* at 2. It is reasonable to infer that the Tax Court was motivated by the same logic when it eliminated the same procedures from the remaining cases tried before STJs a few years later.

C. Deference To An STJ's Credibility Determinations Is Not Constitutionally Compelled

Contrary to petitioners' claim (03-184 Br. 17-19, 29-34, 36, 40-41; 03-1034 Br. 38), disclosure of the STJ's initial credibility assessments is not necessary to prevent the Tax Court from rejecting them "without seeing and hearing the witness" in violation of *United States* v. *Raddatz*, 447 U.S. 667, 681 n.7 (1980).

At the outset, even if Tax Court judges were engaged in such a practice, it would raise no constitutional concern here. The suggestion in *Raddatz* that a judge's rejection of a magistrate's credibility determinations without hearing the witnesses "could well give rise to serious questions" was made in the context of a *criminal* proceeding, 447 U.S. at 681 n.7, which requires an Article III forum and a higher level of procedural protection than is required in civil tax cases. See *Moyer* v. *Peabody*, 212 U.S. 78, 84 (1909) ("[D]ue process of law depends on circumstances. * * * Thus summary proceedings suffice for taxes, and executive decisions for exclusion from the country.") (citing *Murray's Lessee*, 59 U.S. (18 How.) at 282); *BMW of N. Am., Inc.* v. *Gore*, 517 U.S. 559, 575 n.22 (1996) (observing that "[t]he strict constitutional safeguards afforded to criminal defendants are not applicable to civil cases") (internal citation omitted).

Far from requiring non-Article III courts to accept the factual determinations of hearing examiners, this Court has rejected claims that due process requires a non-Article III decisional authority to defer to a hearing officer or rehear the evidence firsthand. Thus, in *Morgan* v. *United States*, 298 U.S. 468, 481 (1936) (*Morgan I*), this Court concluded that the Secretary of Agriculture could, consistent with due process, enter factual findings after reviewing only a cold record containing evidence received by a hearing examiner:

> Evidence may be taken by an examiner. Evidence thus taken may be sifted and analyzed by competent subordinates. * * * The requirements are not technical. But there must be a hearing in a substantial sense. And to give the substance of a hearing, which is for the purpose of making determinations upon evidence, the officer who makes the determinations must consider and appraise the evidence which justifies them.

Id. at 481-482.

Similarly, in *NLRB* v. *Mackay Radio & Telephone Co.*, 304 U.S. 333, 350-351 (1938), the Court concluded that due process was not violated by the NLRB's issuance of its own findings and conclusions in a case heard by a trial examiner, even though the Board failed "to follow its usual practice of the submission of a tentative report by the trial examiner and a hearing on exceptions to that report." *Id.* at 350. The court reasoned that so long as "the issues and contentions of the parties were clearly defined and * * * no other detriment or disadvantage is claimed," the parties receive a "full and adequate hearing" within the meaning of the Due Process Clause by the deciding body's review of the cold record. *Id.* at 350-351.

Ballard attempts (Br. 32) to sidestep the clear import of *Morgan I* and *Mackay* by characterizing the proceeding below as "a fraud case." While the imposition of a fraud penalty was at issue here, the proceedings involved solely civil liability under the Internal Revenue Code, and there has been no argument that those penalties are so substantial as to constitute a quasi-criminal penalty. Accordingly, what rule might apply in a criminal case is not at issue here.

In any event, *Raddatz* does not compel the conclusion that the Tax Court's procedures violate due process. In *Raddatz*, this Court considered whether a district court judge could review de novo the credibility assessments of a magistrate judge who had conducted a suppression hearing in a criminal trial. 447 U.S. at 678-681. The Court held that although "courts must always be sensitive to the problems of making credibility determinations on the cold record," *id.* at 679, the Constitution does not preclude de novo review as long as the reviewing court may rehear evidence when making a credibility determination. Such a statutory scheme "includes sufficient procedures to alert the district court whether to exercise its discretion to conduct a hearing and view the

witnesses itself." *Id.* at 680-681. In a subsequent case, the Court confirmed that "[t]he principal constitutional argument advanced and rejected in *Raddatz* was that the omission of a requirement that the trial judge must hear the testimony of the witnesses whenever a question of credibility arises violated the Due Process Clause of the Fifth Amendment. Petitioner has not advanced a similar argument in this case, no doubt because it would plainly be foreclosed by our holding in *Raddatz*." *Peretz* v. *United States*, 501 U.S. 923, 937 (1991).

Tax Court Rule 183 provides precisely the protection deemed sufficient in *Raddatz*, because it authorizes Tax Court judges to "receive further evidence" and "direct the filing of additional briefs" at their discretion. Tax Ct. R. 183(c). Accordingly, the Tax Court's procedures, on their face, satisfy the command of *Raddatz*.

D. Disclosure Is Not Required By *Mathews* v. *Eldridge*

Disclosure of STJ reports is not, contrary to petitioners' claim (03-1034 Br. 17, 25-27; 03-184 Br. 17, 47-48), independently required by *Mathews* v. *Eldridge*, 424 U.S. 319 (1976), which requires a balancing of "the private interest that will be affected by the official action," "the risk of an erroneous deprivation of such interest through the procedures used," "the probable value, if any, of additional or substitute procedural safeguards," and "the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." *Id.* at 335.

Petitioners were afforded extensive pre-deprivation process: They received notice of the government's claim; a public hearing prior to the government's assessment of tax liability; an opportunity to present evidence during a trial that generated almost 5,500 pages of transcript, more than 4,600 pages of briefs, and thousands of exhibits consuming

hundreds of thousands of pages in the record (03-1034 Pet. App. 3a); a published opinion detailing the Tax Court's reasons for decision, including the factual findings and legal conclusions ultimately recommended by the STJ; and an opportunity to appeal the Tax Court's decision to the federal courts of appeals. In addition, petitioners had the option, which they chose not to exercise, of litigating this dispute in an Article III court by paying the disputed tax and filing a refund action in federal district court.

This process more than satisfies the *Mathews* balancing test. The "private interests" affected by non-disclosure, namely the alleged risk of an "erroneous deprivation" of an individual's funds, are insignificant in light of the extensive hearing petitioners received under the Tax Court's rules. Indeed, this Court held in *Morgan I*, 298 U.S. 468, that a litigant's private financial interest in a civil case does not require an examiner even to prepare a written report, because the litigant's interests are amply protected by the underlying hearing. It follows that such reports need not be disclosed to protect the taxpayers' interests if they are, in fact, prepared. That is particularly true where, as here, the Tax Court judge has adopted the final recommendations of the STJ in full.

In contrast, the government's interest in retaining the current system is substantial. As explained earlier, the broader policy of refusing to disclose non-final reports and other aspects of the deliberative process is vital to the proper functioning of the Tax Court. See pp. 16-17, *supra*. Non-disclosure also eliminates an additional layer of unnecessary and time-consuming review and thus enhances the Tax Court's ability to resolve cases efficiently and to speak with one voice. See pp. 34-36, *supra*. Finally, the government has a substantial interest in tax collection procedures generally, because collection of taxes is "the exercise of a sovereign prerogative, incident to the power to enforce the

obligations of the delinquent taxpayer himself, * * * grounded in the constitutional mandate to 'lay and collect taxes.'" *United States* v. *Rodgers*, 461 U.S. 677, 697 (1983).[11] Because disclosure does not materially advance taxpayer protection, the Tax Court's interest in maintaining its current process must prevail under *Mathews*.[12]

III. DISCLOSURE OF STJ REPORTS IS NOT COMPELLED BY THE INTERNAL REVENUE CODE

Petitioners and their amici suggest in the alternative (03-184 Br. 23; 03-1034 Br. 18, 42-49) that disclosure of STJ reports is compelled by the Internal Revenue Code's appellate review provision, 26 U.S.C. 7482(a)(1), and its disclosure provisions, 26 U.S.C. 7459, 7461. While the Tax Court is required to publish STJ reports to the extent the court adopts the STJ's recommendations, see 26 U.S.C. 7459(b), 7461, petitioners err in contending that an abandoned STJ report must be included in the record.

A. Disclosure Is Not Required Under Section 7482(a)(1)

Internal Revenue Code Section 7482(a)(1) requires that courts of appeals "review the decisions of the Tax Court * * * in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." 26 U.S.C. 7482(a)(1). Clearly, the "decision[]" that

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[11] For that reason, the Court has tended to take a narrow view of the process required in tax cases. See pp. 30-31, *supra*; *Phillips* v. *Commissioner*, 283 U.S. 583, 595-597 (1931). The more limited reach of due process in the tax context, indeed, suggests that *Mathews* may not provide the proper framework for evaluating the Tax Court's procedures. See *Dusenbery* v. *United States*, 534 U.S. 161, 167-168 (2002) (observing that the Court has "never viewed *Mathews* as announcing an all-embracing test for deciding due process claims").

[12] For the same reason, petitioners' reliance (03-184 Br. 32 n.26) on *Goldberg* v. *Kelley*, 397 U.S. 254 (1970), which also suggests a balancing approach to determine the process due, is misplaced.

Congress intends appellate courts to review under Section 7482(a)(1) is the published opinion of the Tax Court, not the discarded "original" report of an STJ. By its terms, Section 7482(a)(1) identifies the decision for review as the "decision[] *of the Tax Court*" (emphasis added). Throughout the Internal Revenue Code, the term "decision of the Tax Court" is used to mean the decision entered by a regular judge of the Tax Court. Section 7459(a) of the Internal Revenue Code, for example, requires that the "decision[]" of the Tax Court "be made by a *judge* in accordance with the report of the *Tax Court*." 26 U.S.C. 7459(a) (emphasis added).[13] Similarly, Section 7459(b) recognizes that the Tax Court must "include in *its* report upon any proceeding *its* findings of fact or opinion or memorandum opinion." 26 U.S.C. 7459(b) (emphasis added). Where Congress intended entities other than the court's regular judges to enter the "decision[] of the Tax Court," it expressly provided for such entry. In particular, Section 7443A(c) specifies the limited circumstances in which "[t]he court may authorize a special trial judge to make the decision of the court." 26 U.S.C. 7443A(c). Those circumstances do *not* include proceedings like this case, and thus it is clear that an STJ's unadopted "original" report is not the "decision of the Tax Court" subject to appellate review.

It is equally clear that Congress did not intend the "in the same manner" language of Section 7482(a)(1) to import the standards or procedural rules applicable to proceedings before a magistrate judge (see 03-1034 Br. 27-28; Amicus Lederman Br. 11). Rather, the "same manner" requirement was added to clarify the scope of review in Tax Court proceedings after this Court held in *Dobson* v. *Commissioner*, 320 U.S. 489, 501-502 (1943), that Tax Court decisions were

[13] The Code consistently uses the term "judge" to refer to Tax Court judges, whereas the designation "special trial judge" is used to refer to STJs. *E.g.*, 26 U.S.C. 7456(a) ("any judge *or special trial judge* * * * may administer oaths") (emphasis added).

subject to limited appellate review in light of the then-applicable statutory language requiring appellate courts to determine whether Tax Court decisions were "in accordance with law." *Id.* at 492; see Revenue Act of 1926, ch. 27, § 1003(b), 44 Stat. 9, 110. The "in the same manner" and "to the same extent" language merely clarified that Congress did not intend appellate courts to give special deference to Tax Court decisions.[14] See H. R. Rep. No. 2087, 80th Cong., 2d Sess. 16 (1948) (observing that intention was "to overrule the principle enunciated by the Supreme Court in the Dobson case * * * [which] had the effect of limiting the scope of the review of the cases decided by the Tax Court."); *InverWorld, Ltd.* v. *Commissioner*, 979 F.2d 868, 874 (D.C. Cir. 1992) (observing that Section 7482(a)(1) addresses only scope of review and "was not intended to bind the courts to any particular procedure for determining which *final* decisions are immediately appealable").

B. Disclosure Is Not Required Under Section 7459 Or 7461

Kanter (Br. 42-46) also erroneously reads the Internal Revenue Code's disclosure provisions to require disclosure of original STJ reports. See 26 U.S.C. 7461(a), 7459(b). By their terms, those provisions require disclosure only of reports adopted by the Tax Court.

Section 7461(a) provides that "all reports *of the Tax Court* and all evidence received by the Tax Court and its divisions * * * shall be public records open to the inspection of the public." 26 U.S.C. 7461(a) (emphasis added). Similarly,

[14] Amicus Professor Leandra Lederman further errs in arguing (Br. 11-22) that STJ reports are evidence that must be included in the record in the same way magistrate judge reports are considered "original evidence" under the Federal Rules of Appellate Procedure. Under federal law, magistrate judges and special masters are *required* to file their reports with the district court and serve them on parties. That is not the case with STJ reports under the Internal Revenue Code. See pp. 33-34, *supra*.

Section 7459(b) provides that "[i]t shall be the duty of the Tax Court and of each division to include in *its* report upon any proceeding *its* findings of fact or opinion or memorandum opinion," and that "[t]he Tax Court shall report in writing all *its* findings of fact, opinions, and memorandum opinions." 26 U.S.C. 7459(b) (emphasis added). The phrase "report of the Tax Court" as used in those provisions is elucidated in Section 7459(a) of the Internal Revenue Code, which creates the "report" requirement. It provides that the report "of the Tax Court" is the document that serves as the basis for the "decision of the Tax Court," and that "[t]he decision *shall* be made by a judge *in accordance with* the report of the Tax Court." 26 U.S.C. 7459(a) (emphases added). Because the STJ's report cannot serve as the Tax Court's decision unless adopted by a judge of the Tax Court, see pp. 24-25, *supra*, reports that are not adopted cannot be the "report of the Tax Court" to which the disclosure requirements refer.

Kanter's attempt to bolster (Br. 43) his reading of those provisions by referencing a single case in which a court "referr[ed] to" the STJ report as the "initial report of the Tax Court," see *Louisville & Nashville R.R.* v. *Commissioner*, 641 F.2d 435, 443 (6th Cir. 1981), is unavailing. A single imprecise choice of words in a lower court opinion that does not consider the meaning of the Internal Revenue Code's disclosure provisions is not persuasive authority as to their meaning. Similarly, Kanter errs in relying (Br. 47-49) on a Senate Report stating that the disclosure provisions "will provide that all such proceedings, records, and evidence in connection therewith shall be public," S. Rep. No. 398, 68th Cong., 1st Sess. Pt. 2, at 12 (1924). The Senate Report does not describe the kinds of documents Congress intended to subject to disclosure, and thus its mere recognition of a disclosure requirement begs the question here.

Kanter's argument, moreover, would lead to absurd results. If abandoned STJ reports were "report[s] of the Tax Court," they would have to be published in the Tax Court's official case reports "for public information and use." 26 U.S.C. 7462. Indeed, Tax Court judges would be barred from modifying STJ reports under Kanter's interpretation of the Code, because Section 7459(a) *requires* the decision of the Tax Court to be "made * * * in accordance with the report of the Tax Court." That result, of course, is plainly contrary to Congress's intent. See 26 U.S.C. 7443A(b)(4) & (c).

Kanter's secondary argument (Br. 40-42) that any report submitted by the STJ is "evidence" within the meaning of the disclosure provisions mistakenly assumes that the STJ functions as a party litigant in the case such that the STJ's statements have "evidentiary" value. The case on which Kanter relies for that argument, *Gonzales* v. *United States*, 348 U.S. 407 (1955), demonstrates the flaw in the argument. In *Gonzales*, this Court held that an individual seeking a deferment from military service was entitled to review a Department of Justice recommendation concerning the deferment request that had been submitted to the Selective Service Appeal Board, the agency with authority to decide the request. *Id.* at 412. The Court reasoned that, because the Department of Justice was the entity framing the arguments against petitioner's deferment request, "petitioner was entitled to know the thrust of the Department's recommendation so he could muster his facts and arguments to meet its contentions." *Id.* at 414. As the Court noted, the "right to a hearing embraces * * * a reasonable opportunity to know the claims of the opposing party." *Id.* at 414 n.5 (quoting *Morgan* v. *United States*, 304 U.S. 1, 18 (1938)). In this case, the opposing party is the Commissioner of Internal Revenue, not the STJ. It is the Commissioner's submissions that frame the arguments against petitioners,

and those submissions are, of course, disclosed and become part of the record. The STJ, in contrast, operates within the adjudicative body itself, and his statements are not evidence.[15]

C. There Is No Common Law Right To Disclosure Of STJ Reports And No Cause For An Exercise Of The Court's Supervisory Powers

Kanter is wrong to claim (Br. 44-46) that the "common-law" right of access extends to STJ reports. Indeed, because the question whether disclosure is compelled by an alleged "common law right" is not fairly contained in the questions presented, it is not a question that this Court should review. See Sup. Ct. R. 14.1(a). In any event, the common law right has never been interpreted to extend to a court's internal deliberations. Thus, the public has no right of access to court conferences, draft opinions, or internal court memoranda, just as a party has no right to take discovery of a judge's thought processes. See pp. 16-17, *supra*.

Nor would an exercise of this Court's supervisory powers be appropriate. Again, that issue is not fairly included in the questions presented. In any event, the exercise of supervisory power sought by Kanter (03-1034 Br. 49-50) would be outside the normal scope of that power. This Court has never exercised its supervisory authority to alter the rules of an Article I tribunal, such as the Tax Court, that has been vested by Congress with exclusive authority to promulgate its own rules, and it should not do so here. See 26 U.S.C. 7453, 7443A; compare 26 U.S.C. 2071(a) & 2072(a) (conferring authority on this Court to prescribe rules for itself and for district courts, magistrates, and courts of appeals, but not the Tax Court); see also *Dickerson* v. *United States*, 530 U.S. 428, 437 (2000) ("supervisory authority over the federal courts" is subject to "ultimate authority" of Congress absent constitutional constraints).

[15] Kanter also characterizes this argument (Br. 39-42) as implicating his right to an effective "hearing" before the Tax Court. That issue is not fairly included within the questions presented, which are limited to issues of appellate review.

CONCLUSION

The judgments of the courts of appeals should be affirmed.

Respectfully submitted.

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APPENDIX

1. 26 U.S.C. 7443A (1994) provided in pertinent part:

Special trial judges

(a) Appointment. The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.

(b) Proceedings which may be assigned to special trial judges. The chief judge may assign—

(1) any declaratory judgment proceeding,

(2) any proceeding under section 7463,

(3) any proceeding where neither the amount of the deficiency placed in dispute (within the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000, and

(4) any other proceeding which the chief judge may designate,

to be heard by the special trial judges of the court.

(c) Authority to make court decision. The court may authorize a special trial judge to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3) of subsection (b), subject to such conditions and review as the court may provide.

* * * * *

2. 26 U.S.C. 7459(a) and (b) provide:

Reports and decisions

(a) Requirement. A report upon any proceeding instituted before the Tax Court and a decision thereon shall be made as quickly as practicable. The decision shall be made by a judge in accordance with the report of the Tax Court, and such decision so made shall, when entered, be the decision of the Tax Court.

(b) Inclusion of findings of fact or opinions in report. It shall be the duty of the Tax Court and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Tax Court shall report in writing all its findings of fact, opinions, and memorandum opinions. Subject to such conditions as the Tax Court may by rule provide, the requirements of this subsection and of section 7460 are met if findings of fact or opinion are stated orally and recorded in the transcript of the proceedings.

* * * * *

3. 26 U.S.C. 7460(b) provides:

Provisions of special application to divisions

(b) Effect of action by a division

The report of the division shall become the report of the Tax Court within 30 days after such report by the division, unless within such period the chief judge has directed that such report shall be reviewed by the Tax Court. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Tax Court except in accordance with such rules as the Tax

Court may prescribe. The report of a division shall not be a part of the record in any case in which the chief judge directs that such report shall be reviewed by the Tax Court.

4. 26 U.S.C. 7461(a) provides:

Publicity of proceedings

(a) General rule. Except as provided in subsection (b), all reports of the Tax Court and all evidence received by the Tax Court and its divisions, including a transcript of the stenographic report of the hearings, shall be public records open to the inspection of the public.

5. 26 U.S.C. 7462 provides:

Publication of reports

The Tax Court shall provide for the publication of its reports at the Government Printing Office in such form and manner as may be best adapted for public information and use, and such authorized publication shall be competent evidence of the reports of the Tax Court therein contained in all courts of the United States and of the several States without any further proof or authentication thereof. Such reports shall be subject to sale in the same manner and upon the same terms as other public documents.

6. 26 U.S.C. 7482(a)(1) provides:

Courts of review

(a) Jurisdiction.

(1) In general. The United States Courts of Appeals (other than the United States Court of Appeals

for the Federal Circuit) shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

7. Tax Court Rule 183 provides:

Other Cases

Except in cases subject to the provisions of Rule 182 or as otherwise provided, the following procedure shall be observed in cases tried before a Special Trial Judge:

(a) Trial and Briefs: A Special Trial Judge shall conduct the trial of any such case assigned for such purpose. After such trial, the parties shall submit their briefs in accordance with the provisions of Rule 151. Unless otherwise directed, no further briefs shall be filed.

(b) Special Trial Judge's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the Special Trial Judge shall submit a report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a Judge or Division of the Court.

(c) Action on the Report: The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive

further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

8. Tax Court Rule 182 (1974) provided:

Post-Trial Procedure

Except in small tax cases (see Rule 183) or as otherwise provided, the following procedure shall be observed in cases tried before a commissioner:

(a) Proposed Findings and Briefs: Each party shall file his initial brief, including his proposed findings of fact and legal argument, within 60 days after the date on which the trial is concluded, unless otherwise directed. A party thereafter desiring to file a responsive brief shall do so, including any objections to any proposed findings of fact, within 30 days after the expiration of the period for filing the initial brief, unless otherwise directed. With respect to the content, form, number of copies, and other applicable requirements, the proposed findings of fact and the briefs shall conform to the provisions of Rule 151.

(b) Commissioner's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the commissioner shall file his report, including his findings of fact and opinion. A copy of the report shall forthwith be served on each party.

(c) Exceptions: Within 45 days after service of the commissioner's report, a party may file with the Court a brief setting forth any exceptions of law or of fact to that report. Within 30 days of service upon him of such brief, any other party may file a brief in response thereto. In any brief filed pursuant to this paragraph, a party may rely in whole or in part upon the briefs previously submitted by him to the commissioner under paragraph (a) of this Rule 182. Unless a party shall have proposed a particular finding of fact, or unless he shall have objected to ar other party's proposed finding of fact, the Court may refuse to consider his exception to the commissioner's report for failure to make such a finding desired by him or for inclusion of such finding proposed by the other party, as the case may be.

(d) Oral Argument and Decision: The Division to which the case is assigned may, upon motion of any party or on its own motion, direct oral argument. The Division inter alia may adopt the commissioner's report or may modify it or may reject it in whole or in part, or may receive further evidence, or may recommit it with instructions. Due regard shall be given to the circumstance that the commissioner had the opportunity to evaluate the credibility of witnesses; and the findings of fact recommended by the commissioner shall be presumed to be correct.

9. Tax Court Rule 48 (1944) provided:

Commissioners of the Tax Court

(a) The term "commissioner" as used in this Rule 48 applies to any attorney on the legal staff of this Court who shall have been designated by the

Presiding Judge as a "commissioner in a particular case" pursuant to section 1114 of the Internal Revenue Code, as amended by section 503 of the Revenue Act of 1943.

(b) The commissioner shall conduct the hearing in such case in accordance with the Court's rules of practice. He shall rule upon objections and other evidentiary matters in accordance with the rules of evidence as provided in section 1111, and shall exercise such further and incidental authority, including the issuance of subpoenas, as may be necessary for the conduct of the hearing.

(c) Unless otherwise directed the parties shall have 30 days from the closing of proof in the case for filing proposed findings of fact. Such findings of fact shall be prepared in the manner and form prescribed in the first paragraph of Rule 35(b).

Upon the filing by the parties of their proposed findings of fact, the commissioner shall prepare and submit to the Court or a Division thereof a report of his findings of fact based upon the evidence in the case, and copies thereof shall be served upon both parties.

Within 20 days from the filing of the commissioner's proposed findings of fact the parties may file exceptions thereto which will be considered by the Division to which the case is assigned.

(d) Unless otherwise directed by the Court, the parties shall have 45 days from the date of the filing of the commissioner's proposed findings of fact within which to file briefs, and 15 days additional

within which to file reply briefs. Each brief shall be prepared in the manner and form prescribed in Rule 35.

(e) Upon motion of either party, or upon its own motion, the Division to which the case is assigned may in its discretion direct oral argument and set a date therefor.

10. United States Tax Court General Order Number 5 (1976) provided:

Additional Cases Assigned to Special Trial Judges

A. Purpose

Both the number of new cases filed in the United States Tax Court and the total number of cases involving deficiencies under $2,500 have increased substantially in the past year, and there is reason to believe that the work of the Court will continue at a higher level. Thus, it appears advisable to make changes in the present practices of the Court in order to dispose of pending cases more promptly and efficiently. To accomplish those objectives, it has been decided that additional cases should be assigned to the Special Trial Judges of the Court for trial or other disposition.

B. Cases Assigned

The Court has followed the practice of assigning most of the "small tax cases" to Special Trial Judges for trial or other disposition. The work of the Court has been reviewed for the purpose of deciding what additional cases could be assigned to the Special Trial Judges. We have sought to select

cases in which the parties would find a trial by the Special Trial Judges to be most suitable. In the light of this criterion, it appears appropriate to assign to the Special Trial Judges additional cases involving relatively small deficiencies.

C. Procedures

1. In accordance with this order and Rule 180, Tax Court Rules of Practice and Procedure, the Chief Judge may assign to a Special Trial Judge for trial or other disposition cases which are not "small tax cases" as defined in Rule 171, Tax Court Rules of Practice and Procedure, but in which the amount of the deficiency in income or gift taxes does not exceed $2,500 in any one taxable year or the deficiency in estate tax does not exceed $2,500.

2. All proceedings in cases assigned to Special Trial Judges in accordance with this order shall be conducted in accordance with the Tax Court Rules of Practice and Procedure, and the Special Trial Judges shall have all the powers described in Rule 181. However, Rule 182 provides in part that its provisions are applicable "[e]xcept in small tax cases (see Rule 183) or as otherwise provided." Since the amount at issue is small in the cases assigned to the Special Trial Judges in accordance with this order, it is clearly impracticable and undesirable to follow the post-trial procedures set forth in Rule 182. Accordingly, pursuant to the authority of such rule to provide otherwise, it has been decided that such procedures shall not be applicable in the cases assigned to the Special Trial Judges in accordance with this order.

3. If either party objects to having the case tried in accordance with the procedures established by this order, he may file a motion to that effect within 15 days after service of the notice setting the case for trial before a Special Trial Judge, setting forth his objections to having the case so conducted. In considering such motion, the Court will take into consideration the amount in controversy, the significance of the matter at issue, the convenience of the parties, and the responsibilities of the Court.

D. Opinions

As soon as practicable after hearing a case assigned to him in accordance with this order, a Special Trial Judge shall prepare his proposed findings of fact and opinion and submit them to the Chief Judge, or to another Judge designated by him for that purpose. The proposed findings of fact and opinion of the Special Trial Judge shall not constitute the findings of fact and opinion of the Court unless reviewed and adopted by the Judge to whom the case is assigned, and the report is approved by the Chief Judge.

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IN THE

Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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REPLY BRIEF ON THE MERITS

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REPLY BRIEF ON THE MERITS

INTRODUCTION

The Rule 183(b) report represents the only record of the presumptively correct factual findings made independently by the only judicial officer to attend the trial and observe the testimony. Despite the obvious importance of the Special Trial Judge's ("STJ") fact-findings, the IRS argues that a copy of the Rule 183(b) Report need not be included with the record provided to reviewing Article III courts—including this Court. The IRS contends that reviewing Article III courts should be denied the ability to verify that the Tax Court's final opinion did treat the Rule 183(b) Report with "due regard" or review the basis for any actual "modification" or "rejection" of an STJ report. The Tax Court's insistence on keeping the original factfindings secret from both the Article III courts and the parties is plainly contrary to the statutory

and constitutional requirement of Article III review and departs so far from traditional American practice as to violate Due Process guarantees.

As it has throughout these proceedings, the IRS fails to distinguish between the Rule 183(b) Report that the Special Trial Judge is required to prepare and the opinion that is ultimately released by the Tax Court. There is ***only one*** Rule 183(b) Report: by statute and rule it is prepared by the STJ in the wake of the trial and submitted to the Chief Judge of the Tax Court. The STJ submits his Rule 183(b) Report *before* a Regular Tax Court Judge is assigned to the case, and this submission ends the STJ's participation in the case. Thereafter, a Regular Tax Court Judge may: (1) adopt the report; (2) modify it; or (3) hear additional testimony or argument. In this case, as in apparently ***every*** case decided by the Tax Court since the implementation of its current Rule 183 in 1984, the final record indicates only that the Rule 183(b) Report was "adopted." No reviewing Article III court has been permitted to determine whether the original factfinder's report was given the "regard" and deference that it is indisputably "due," as required by the text of the Rule, the command of Congress, and Due Process.

Contrary to the IRS's contention, the Rule 183(b) Report is in no way part of the Tax Court's internal deliberative process. Indeed, nowhere in the Tax Court's rules (or anywhere else, at least until the briefing in this case) is there any suggestion that the Rule 183(b) Report will be a "collaborative effort" or that its post-submission review will include the STJ's acceptance of any modifications made by the Regular Tax Court Judge. The IRS further argues, in the alternative, (i) that STJs and Regular Tax Court Judges are analogous to co-equal judges on a panel, jointly producing a decision, and (ii) that the relation of the STJ to the Regular Tax Court Judge is like that of a law clerk to a judge, or staff to the head of an administrative agency. As detailed in this brief and elsewhere, both of these analogies fail: the

employee-at-will STJs are not "peers" with the Regular Tax Court Judges, while law clerks do not preside at trial. But there is one proposition that cannot be disputed: STJs cannot be both equal participants with the Tax Court Judges, like members of the same appellate panel, and also subservient to them, like law clerks.

In the same statute that creates the Tax Court,[1] Congress has directed that the Article III courts of appeals review decisions from the Tax Court "in the same manner and to the same extent as decisions of the district courts," and this compels inclusion of the Rule 183(b) Report in the record. The IRS ignores the fact that the Article III district courts ***always*** include the factfinding from the trier of fact in the record. Congress requires no less of the Tax Court.

As part of its effort to perpetuate the secrecy surrounding the STJ's Rule 183(b) Report, the IRS makes several arguments that simply miss the mark:

- The right to a fair trial in a fraud case involving the personal reputations of individual taxpayers and millions of dollars is not subject to the reduced procedural protections associated with rate-making proceedings or other administrative matters. The IRS has cited no case to the contrary.
- No discovery from the Tax Court is necessary or will be sought. It is simply inaccurate to assert that Petitioners seek to invade the deliberative process of the Tax Court by deposing judges or serving written discovery. Petitioners merely seek the disclosure of the Rule 183(b) Report to the reviewing appellate courts on remand, and no discovery of any kind is necessary to achieve this result.[2]

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[1] 26 U.S.C. § 7482.

[2] Resp. Br. at 30. Far from being an improper invasion of the decisional process, the comparison of legal and factual conclusions is some-

- No finding of judicial misconduct is needed to resolve the question at hand. As with any question of fact or law, the Tax Court may err without engaging in any misconduct by denying the Rule 183(b) Report its presumption of correctness. The inclusion of the Rule 183(b) Report in the record is obviously necessary to guard against this sort of error, regardless of the presence or absence of judicial impropriety.
- This Court's grant of certiorari was not improvident, as no hypothetical future case could more perfectly frame the issue of whether the Rule 183(b) Report must be included in the record. Because the Tax Court *always* purports to "adopt" the STJ's Rule 183(b) Report and the STJ's Report is *never* included in the record, this issue could not reach this Court in any other posture.

ARGUMENT IN REPLY

I. BOTH CONGRESSIONAL COMMAND AND ARTICLE III REQUIRE INCLUSION OF THE RULE 183(b) REPORT IN THE RECORD.

A. Congress' Grant of Article III Review to the Taxpayers Necessitates Review "In the Same Manner and to the Same Extent" as Decisions from a Federal District Court.

The IRS has failed to answer the Petitioners' contention that the statutory command of Congress requires the inclusion of the Rule 183(b) Report in the appellate record. It is

thing that this Court and the courts of appeals regularly undertake in a variety of contexts. For example, this Court regularly examines whether a court of appeals applied the proper standard of review to a district court decision. The courts of appeals themselves regularly compare the factual conclusions reached by district judges to the factual conclusions reached by magistrates or bankruptcy judges.

undisputed that Congress has given taxpayers the right to have their Tax Court cases reviewed by Article III courts "*in the same manner and to the same extent* as decisions of the district courts in civil cases tried without a jury." 26 U.S.C. § 7482 (emphasis added).[3] Consistent with this statutory command, the striking parallel between the language of FED. R. CIV. P. 52(a) and TAX CT. R. 183(c) confirms that the STJ is the only possible trier of fact. In establishing the role of the district judge as the trier of fact in a bench trial, Rule 52(a) mandates that the judge's factfindings "shall not be set aside unless clearly erroneous, and ***due regard*** shall be given to the opportunity of the trial court to judge the credibility of the witnesses." (emphasis added).

Obviously, an Article III appellate court reviewing a decision from a bench trial before a district court has access to the findings of fact made by the district judge. Hence, in order to make possible appellate review of Tax Court decisions "in the same manner and to the same extent"[4] as decisions from a federal district judge, the STJ's Rule 183(b) Report must be included in the record. Thus, the only logical reading of the statute is that it calls for the reviewing Article III court to have access to the findings of the STJ before they are "modified" or "rejected." This is precisely the statutory construction that this Court adopted in *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 493 (1951). This construction pretermits the need for constitutional decision making, as is favored. *See DeBartolo Corp. v. Fla. Gulf Coast Bldg.*, 485 U.S. 568, 575 (1988).

[3] Because Congress has, by statute, given authority over tax cases to the Article III courts, the common law principles from the "court of the exchequer" invoked by the IRS (Resp. Br. at 38) are irrelevant. *See infra* at 13.

[4] 26 U.S.C. § 7482.

B. Article III Requires a Full Record for Meaningful Review.

It is well established that adjudication in an Article I court is valid only where recourse to appellate review in an Article III court is possible.[5] Meaningful Article III appellate review is, of course, entirely dependent on the existence of a full and complete record of the proceedings before the Article I court —and the availability of that record to the Article III court.

The Tax Court's refusal to provide the Article III courts with access to the factfindings of the trier of fact prevents valid Article III review.[6] Indeed, this Court has previously held that findings of fact from the Article I judge hearing the testimony are an essential part of the Article III appellate record: "Surely an examiner's report is as much a part of the record as the complaint or the testimony."[7]

II. THERE IS ONLY ONE RULE 183(b) REPORT, AND NO ARTICLE III COURT KNOWS WHAT IT SAID.

A. The Rule 183(b) Report Constitutes Presumptively Correct Factfindings.

Throughout these proceedings, the IRS has offered divergent, inconsistent, and entirely new explanations for the role of the STJ in the decision making process at the Tax Court.[8] However, as even a brief review of Tax Court Rule 183(b) reveals, the STJ's Report is a distinct, legally required

[5] Ballard's Br. at 24-25 & n. 18.

[6] Further, it is not the prerogative of the Article I trial court to dictate to the Article III appellate court the contents of the record that it will review.

[7] *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 493 (1951) (Frankfurter, J.) (The Court went on to declare that "reviewing courts" should "give to the examiner's report such probative force as it intrinsically commands.").

[8] Ballard's Br. at 17-22.

document authored exclusively by the STJ in the wake of trial and ***before*** a Regular Tax Court Judge is assigned to the case. The Rule 183(b) Report must be understood as the original factfinding in the case, and for that reason, is presumptively correct. Hence, no meaningful Article III appellate review is possible without access to the Report.

The IRS's shifting characterization of the role of the STJ notwithstanding, the Tax Court's use of an STJ under its Rule 183 to adjudicate a case involves several clear and distinct steps:

(1) The STJ is the only judicial officer present at the trial and presides;[9]

(2) Following trial and the submission of briefs from the parties, the STJ prepares his Rule 183(b) Report, containing his findings of fact and opinions of law;

(3) The STJ submits his Rule 183(b) Report to the Chief Judge of the Tax Court, thereby ending the STJ's participation in the case;

(4) Thereafter, the Chief Judge assigns the case to a Regular Tax Court Judge and forwards the STJ's Rule 183 Report to that Judge;

(5) The Regular Tax Court Judge is obligated to afford the findings of fact in the STJ's Rule 183(b) Report a presumption of correctness, but the Regular Tax Court Judge is ultimately responsible for preparing the Tax Court's opinion, and he may recall witnesses to assist him in doing so; and

[9] *Freytag v. CIR*, 501 U.S. 868, 881-82 (1991) (noting that as the lone judicial officer presiding at trial, the STJ has to power to "take testimony, conduct trials, rule on the admissibility of evidence, and . . . enforce compliance with discovery orders.").

(6) In preparing his opinion, the Tax Court Judge may "adopt" or "modify" or "reject in whole or in part" the STJ's Rule 183(b) Report, but he still remains obligated to give the STJ's Report "due regard" and to treat its factfindings as "presumptively correct."

In reviewing these steps, it becomes obvious that that there is only ***one*** Rule 183(b) report—the document prepared by the STJ after trial and submitted to the Chief Judge of the Tax Court. Thus, the IRS's insinuation that the Rule 183(b) Report is merely some sort of "draft" of the Tax Court's final decision is simply inaccurate.[10] Nor, contrary to the IRS's position, does the Rule 183(b) Report stem from any sort of "collaborative" effort between the STJ and the Regular Trial Judge. The STJ cannot, as a practical matter, collaborate with a Regular Tax Court Judge in the preparation of the Report because it is completed and submitted ***before*** the case is assigned to a particular Tax Court Judge. Moreover, the submission of the Rule 183(b) Report to the Chief Judge ends the STJ's role in the case, as no Tax Court rule or procedure provides for any sort of post-submission collaboration between the STJ and the Regular Tax Court Judge. Thus, properly understood, the Rule 183(b) Report is the legally required and exclusive final product of the STJ, who has no role in the case after he submits his Report.

The Regular Tax Court Judge's right to "modify" or "reject" the STJ's Rule 183(b) Report does not eliminate his obligation to give the Report "due regard" or to treat its factual conclusions as "presumptively correct." Indeed, the legal status of the Rule 183(b) Report as the original factfindings in the case is ultimately unaffected by the Regular Tax Court Judge's treatment of the Report. For example, if the Regular Tax Court Judge decides to "reject" or "modify" the Report's factfindings, it must be because the presumption

[10] Resp. Br. at 20, 24.

of correctness attached to those findings was properly overcome. Yet the Tax Court refuses to permit the Article III courts—including even this Court—to know whether the Regular Tax Court Judge decided to "reject" or "modify" the Report's factfindings, let alone to examine whether such action was proper. As it is, no Article III court is in a position to determine whether the Regular Tax Court Judge actually gave the Rule 183(b) Report the deference that it is indisputably owed.

To be sure, the Tax Court could, if it desired, refuse to employ STJs.[11] Instead, the Regular Tax Court Judges could simply conduct all trials themselves, with the assistance of law clerks. If that were the case, the law clerks' memoranda would not be publicly released, nor would they be given any official recognition as worthy of "due regard." At the other end of the spectrum—as Petitioners here suggest—the Tax Court can and should acknowledge that where the STJ is the sole judge who conducted the trial and viewed the witnesses, and where his official factfinding report is required by statute to be reviewed by a higher judge, that report should (at a bare minimum) be part of the record.

But here, by the IRS's argument, the Tax Court (1) should have the freedom and flexibility to allow a subordinate judge acting alone to conduct a trial, while (2) treating that judge's factfinding report as nothing more than the equivalent of a law clerk's preliminary memorandum. This is an unprecedented result. The Tax Court must make a choice: if it means to hire the equivalent of law clerks, it cannot assign trials to be solely conducted by them. But if it gives STJs the responsibility of conducting trials and finding facts based upon evidence, it must make their factfinding reports part of

[11] After all, Congress left it to the Chief Judge's discretion whether STJs will be employed or used. *See* 26 U.S.C. § 7443A.

the record, just as is done in every other context known to the American legal system.

B. The Regular Tax Court Judge's Opinion and the Rule 183(b) Report are Distinct, Regardless of Whether the STJ Ultimately "Joins" the Opinion.

The IRS has posited that the Regular Tax Court Judge and the STJ collaborated in the preparation of the final opinion, *i.e.*, that the STJ ultimately came to agree with or "join" Judge Dawson's opinion.[12] Thus, the IRS's argument goes, the underlying Rule 183(b) Report is reduced to irrelevance and need not be part of the appellate record.

But this argument fails to take into account that the Rule 183(b) Report contains the original and unmodified findings of fact from the only judicial officer present at trial, or to explain what value the absent-from-trial Tax Court Judge adds to the credibility determinations made by the STJ. Beyond this, there is no mechanism in the Tax Court Rules or elsewhere by which the STJ can concur with or dissent from any modifications or rejection of the Rule 183(b) Report. The STJ's post-submission statement purporting to "join" the Tax Court's final opinion has no legal value: it is the Rule 183(b) Report itself, not any after-the-fact statement by the STJ, that is "presumed to be correct."

By way of analogy, a jury's factfindings are not expunged from the record simply because a district judge issues a judgment as a matter of law and the jurors subsequently come to agree with the judge's reasoning. Nor does the fact that jurors changed their minds alter the standard of review applicable on appeal: the jury's original, uninfluenced, independent factfindings remain part of the record and remain entitled to substantial deference regardless of any juror's post-verdict

[12] Resp. Br. at 17-19.

change of heart. Just as a reviewing court of appeals must determine whether a district judge granting JMOL afforded proper deference to the jury's verdict, so too must the courts of appeals be allowed to confirm that the Tax Court properly gave deference to the STJ's Rule 183(b) Report.

C. The STJ Is the Only Possible Factfinder.

The IRS's only answer to the obvious need to include the Rule 183(b) Report in the record is to deny that the STJ is actually the finder of fact and to contend that, as such, his Report is merely an internal court document. In other words, the IRS envisions the "Special ***Trial Judge***" as something far less than a judge and more akin to a stenographer who takes notes on behalf of the absent actual factfinder, the Regular Tax Court Judge. Because the STJ's Rule 183(b) Report is, under the IRS's theory, more akin to a summary of the transcript or, at best, a law clerk's bench memo, it need not be included in the record.[13]

The IRS's argument ignores the reality of practice before the Tax Court. As the only official observer of the testimony, the STJ cannot be analogized to a law clerk, secretary, or other employee whose work is inherently internal in nature. The presumption of correctness that attaches to the Rule 183 Report flows not only from the explicit language of the Tax Court's own rule, but, more importantly, from the STJ's status as the only person on hand at trial to make credibility determinations.[14] Thus, the IRS's attempt to charac-

[13] Resp. Br. at 31-32. *Cf. Freytag v. CIR*, 501 U.S. 868, 881-82 (1991) (holding that STJs "perform more than ministerial tasks" and that "[i]n the course of carrying out these important functions, the special trial judges exercise significant discretion."). In light of this, the IRS appears to be making arguments in the present case that this Court rejected in *Freytag*.

[14] Such credibility determinations are, obviously, all the more important in a fraud case such as this, where the IRS must prove that "the peti-

terize[15] the STJ as anything other than the original finder of fact is disingenuous: there is simply no other *bona fide* candidate for the position.

III. THE *RADDATZ* PRINCIPLE APPLIES TO THIS FRAUD CASE.

Under this Court's precedents, credibility assessments made by a judge who observed the witnesses should rarely, if ever, be reversed on the basis of a cold record by a reviewing judge who was not present at trial. *See United States v. Raddatz*, 447 U.S. 667, 681 (1980); *Peretz v. United States*, 501 U.S. 923, 939 (1991).[16] This was a fraud case where credibility determinations were of vital importance. The dispositive credibility determinations were, by necessity, made by the only judicial officer present at trial—the STJ—and memorialized in his Rule 183(b) Report. Consistent with the *Raddatz* principle, Due Process demands that the credibility determinations in the Rule 183(b) Report be given substantial deference.

The IRS's argument against the applicability of *Raddatz* is flawed. Although this case is not a criminal prosecution, this tax fraud case is closer in form and consequence to a criminal matter than it is to the administrative proceedings concerning rulemaking, rate setting, or license applications invoked by the IRS.[17] As the liberty or property interest at issue increases, so does the level of Due Process protection that must be afforded.[18] Where, as here, a court's actions will "engender adverse social consequences to the individual" or result in

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tioner has been guilty of fraud with intent to evade tax" by "clear and convincing" evidence. 26 U.S.C. § 7454(a); TAX CT. R. 142(b).

[15] Resp. Br. at 31-32.

[16] Ballard's Br. at 32-35.

[17] Resp. Br. at 47-48.

[18] *Addington v. Texas*, 441 U.S. 418, 425-26 (1979).

a "stigma," an increased level of Due Process protection is warranted.[19] Thus, the elevated "clear and convincing" standard of proof applies. The imposition of significant monetary penalties[20] and other purely punitive measures upon Petitioners will accompany a finding of guilt. Moreover, in the business world, fraud carries with it a stigma akin to that of a criminal conviction, and here it is an individual, rather than any institution, who must personally bear that stigma.[21]

The IRS cites no case holding that an absent-from-trial judge is permitted to make factfindings in a quasi-criminal case such as this. Hence, while it may be constitutionally permissible for an absent-from-trial trier of fact to make findings in cases concerning livestock pricing[22] or other technical administrative matters, such absentee factfinding is unacceptable in the context of a fraud trial whose outcome

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[19] *Id.* at 426.

[20] The penalty for tax fraud is a fine of 75% plus interest for any tax deficiency attributable to fraud, plus payment of the underlying tax deficiency. 26 U.S.C. § 6663. Further, the fraud finding caused the statute of limitations not to apply, subjecting the Ballards to liability for tax years long past. 26 U.S.C. § 6501(c)(1). Hence, Petitioners' property interest at issue in this case was quite substantial.

[21] Because he was a well-respected and prominent business figure, the quasi-criminal stigma surrounding a finding of tax fraud has impacted Claude M. Ballard's life in multiple material and negative ways. For example, Mr. Ballard has been forced to resign from several boards of directors on which he formerly sat. His reputation has been damaged and he has endured various business and social consequences as a result of the Tax Court's finding of fraud. Mr. Ballard has endured this stigma, notwithstanding the fact that he reported income on which he paid over $6 million in federal income taxes in the years in question. *See* Trial Exhibits 385-93.

[22] Resp. Br. at 48-49 (relying heavily on *Morgan v. United States*, 298 U.S. 468 (1936), a pre-APA case concerning the Secretary of Agriculture's right to determine without personally hearing live testimony the maximum rate to be charged in the buying and selling of livestock).

hinges almost entirely on the credibility of witnesses. The STJ's apparent post-Report change of heart does not cure this problem.

IV. THE GOVERNMENT'S REMAINING ARGUMENTS FAIL.

Rather than repeat arguments made in other briefs, it is necessary only to note the flaws in several arguments raised by the IRS in the hopes of avoiding the merits of this issue altogether. Specifically, the IRS (1) implies that this case turns on some kind of judicial impropriety; and (2) that a reversal will somehow require or invite discovery from the Tax Court itself; and (3) that certiorari was improvidently granted. For the reasons detailed *supra* on pages three and four, these arguments are red herrings.

V. THE TAX SYSTEM IS UNDER THE PURVIEW OF THE ARTICLE III COURTS.

The IRS's desire to deny reviewing Article III courts access to the Rule 183(b) Report based, in part, on ancient common law "court of exchequer" practices[23] reflects the IRS's failure to recognize that Congress has placed the tax system under the purview of the Article III courts. Not only is the Tax Court subject to review by the Article III courts, the Tax Court itself has steadily evolved into a forum closely resembling a district court.[24] Yet the IRS apparently believes that the Tax Court is still immune to the strong public policy favoring judicial transparency.[25]

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[23] Resp. Br. at 38-39. Ballard's Br. at 46.

[24] Harold Dubroff, *The United States Tax Court: An Historical Analysis* (pts. 1-6), 40 ALB. L. REV. 7 (1975), 40 ALB. L. REV. 253 (1976), 41 ALB. L. REV. 1 (1977), 41 ALB. L. REV. 639 (1977), 42 ALB. L. REV. 161 (1978), 42 ALB. L. REV. 353 (1978).

[25] Ballard's Br. at 46.

Consistent with its evolution towards transparency and accountability, the Tax Court should not be allowed to conceal the factfindings in this or any other case. The IRS's invocation of English exchequer practice notwithstanding, Congress demands more of the Tax Court: meaningful Article III review, which requires the inclusion of the factfindings in the record. To hold otherwise is to permit a degree of secrecy otherwise unknown in the modern American legal system and wholly inconsistent with the Tax Court's transformation into a trial court more closely akin to the federal district courts.

CONCLUSION

For all of the foregoing reasons, the judgment of the court of appeals should be vacated in its entirety, and this case remanded for further proceedings consistent with this Court's opinion, including an order that the report of the Special Trial Judge be provided to the parties and made part of the appellate record.

Respectfully submitted,

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In The
Supreme Court of the United States

CLAUDE M. BALLARD, ET UX.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF BURTON W. KANTER, ET AL.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ Of Certiorari To The United States Courts Of Appeals For The Seventh And Eleventh Circuits

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INTEREST OF THE *AMICA CURIAE*

Amica is a professor of tax law with a long-standing interest in the operation of the United States Tax Court ("Tax Court") and its role in the federal system. She has written extensively on tax procedure, with an emphasis on issues relating to the Tax Court. She is co-author of *Tax Controversies: Practice and Procedure* (2d ed. 2002) and served as General Editor of *Federal Tax Practice and Procedure* (2003).[1]

SUMMARY OF THE ARGUMENT

One of the questions in this case is whether the Tax Court effectively can shield from appellate review the work of its Special Trial Judges in the largest cases over which those judges preside, cases heard under Tax Court Rule 183. Internal Revenue Code § 7482(a) provides, in relevant part, that "[t]he United States Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . . ." I.R.C. § 7482(a)(1). The Tax Court's current practice of keeping the reports of Special

[1] Pursuant to this Court's Rule 37.3(a), *amica curiae* is filing this brief with the written consents of all of the parties, which are being submitted with this brief. Pursuant to this Court's Rule 37.6, *amica* states that this brief was not authored in whole or in part by counsel for any party. *Amica* received no monetary contribution to the preparation or submission of this brief apart from the general financial support of the two academic institutions with which she is affiliated. The views expressed in this brief are those of *amica* and do not necessarily reflect the views of either institution.

Trial Judges in Rule 183 cases out of the record on appeal violates this statute because it renders the United States Courts of Appeals incapable of reviewing Tax Court decisions "to the same extent" as bench trials in the district courts.

ARGUMENT

In the Tax Court trial that gave rise to this appeal, the court assigned one of its Special Trial Judges ("STJs") to try the case. *See Investment Research Assoc. v. Commissioner*, 78 T.C.M. (CCH) 951 (1999) (Tax Court opinion below, reflecting assignment to Special Trial Judge D. Irvin Couvillion). STJs are inferior officers of the United States. *Freytag v. Commissioner*, 501 U.S. 868, 881-82 (1991). By statute, the Chief Judge of the Tax Court is authorized to assign to STJs any Tax Court proceeding, I.R.C. § 7443A(b), but the STJ may not "make the decision of the court" in cases in which more than $50,000 is placed in dispute, I.R.C. § 7443A(c); *see also Freytag*, 501 U.S. at 875 n.3.

In Tax Court Rule 183, the Tax Court has prescribed procedures for the conduct of these large cases. *See* Tax Ct. R. 183. Under that rule, the STJ conducts the trial, after which, the parties submit briefs. Tax Ct. R. 183(a). Rule 183 also provides that "[a]fter all the briefs have been filed by all the parties or the time for doing so has expired, *the Special Trial Judge shall submit a report, including findings of fact and opinion*, to the Chief Judge . . . ." Tax Ct. R. 183(b) (emphasis added). Thus, in a large case heard by a STJ, it is the STJ who makes findings of fact and

writes an opinion, both of which are reflected in a report submitted to the Chief Judge of the Tax Court.

Tax Court Rule 183 further mandates that *"[d]ue regard* shall be given to the circumstance that the *Special Trial Judge had the opportunity to evaluate the credibility of witnesses*, and the *findings of fact recommended by the Special Trial Judge shall be presumed to be correct."* Tax Ct. R. 183(c) (emphasis added). Yet, the Tax Court's current practice is to shield the STJ's report from the eyes and oversight of even a reviewing Court of Appeals. *See* Leandra Lederman, *Transparency and Obfuscation in Tax Court Procedure*, 102 Tax Notes 1539, 1540 (Mar. 22, 2004).

The Tax Court's current practice of keeping STJ reports confidential reflects a change from its prior procedure; through 1983, the applicable Tax Court rule both expressly required a copy of the STJ's report to be served on each party and provided the parties with an opportunity to file exceptions to the report. *See* Tax Ct. R. 182(b), (c), 60 T.C. 1149 (1973) (repealed 1984). "There is no public indication why the Tax Court rules and procedures were changed in 1983 to the current system . . . ." *Estate of Kanter v. Commissioner*, 337 F.3d 833, 879 (7th Cir. 2003) (Cudahy, J., concurring in part and dissenting in part). Moreover, this "abandon[ment] [of] a transparent process" reflects "an evolution completely counter to the trend towards transparency in analogous areas of the law." *Id.*

The Tax Court is a creature of statute, see I.R.C. § 7441, and Congress has provided that "[t]he Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title [and other specified statutes]." I.R.C. § 7442. Congress has delegated to the Tax Court the task of promulgating rules of practice and procedure for

the conduct of its proceedings, both generally and with respect to STJs. *See* I.R.C. §§ 7443A(a), 7453. However, the Tax Court does not write its rules in a vacuum. "[The Tax Court's] authority under 26 U.S.C. § 7453 . . . is limited to maintaining control over the court's own docket and proceedings." *Daccarett-Ghia v. Commissioner*, 70 F.3d 621, 625 (D.C. Cir. 1995); *cf. Board of Tax Appeals v. United States*, 37 F.2d 442, 443 (D.C. Cir. 1929) ("The Commissioner . . . must be given an opportunity to be heard, and no rule of the Board [of Tax Appeals] can deprive him of the statutory right thus conferred.").

Sections 7443A and 7453 of the Internal Revenue Code do not grant the Tax Court the authority to regulate the conduct of other courts, such as the Courts of Appeals. Congress has specifically provided that "[r]ules for review of decisions of the Tax Court shall be those prescribed by the Supreme Court under section 2072 of Title 28 of the United States Code." I.R.C. § 7482(c)(2). Thus, Tax Court rules, such as Rule 183, cannot determine how the Courts of Appeals review decisions of the Tax Court and should not be interpreted so as to limit the scope of that review.[2] Instead, rules that this Court has promulgated under 28 U.S.C. § 2072 and applicable federal statutes must govern that review.

The key statute governing review of Tax Court decisions is § 7482. It provides the United States Courts of Appeals with jurisdiction to review decisions of the Tax

[2] Current Tax Court Rule 183 does not forbid disclosure of the STJ's report; the provisions mandating that disclosure were removed but not replaced with any prohibition of the prior practice. *See* Tax Ct. R. 183 & note on amendments to rule, 81 T.C. 1069-70 (1983).

Court "*in the same manner and to the same extent as decisions of the district courts* in civil actions tried without a jury . . . ." I.R.C. § 7482(a)(1) (emphasis added). As discussed below, this statute requires the STJ's report to be included in the record on appeal, both because that report cannot otherwise be accorded the weight required by law and because, in district court, the original findings of fact and opinion are included in the record on appeal, even if those findings and opinion are those of a judicial officer rather than a judge.

I. THE SPECIAL TRIAL JUDGE'S REPORT MUST BE INCLUDED IN THE RECORD ON APPEAL IN ORDER FOR THE ORIGINAL FINDINGS OF FACT OF THE TRIAL JUDGE TO RECEIVE THE REVIEW REQUIRED BY LAW

This Court has interpreted § 7482(a)(1) as requiring Tax Court decisions to receive the same standard of review as district court decisions, so that Federal Rule of Civil Procedure 52(a) applies to review of Tax Court decisions. *See Commissioner v. Duberstein*, 363 U.S. 278, 291 & n.13 (1960) (*citing Grace Bros., Inc. v. Commissioner*, 173 F.2d 170, 173 (9th Cir. 1949)). Federal Rule of Civil Procedure 52(a) provides, in part that "[f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and *due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses*." Fed. R. Civ. P. 52(a). Thus, in Tax Court, as in district court, findings of fact are subject to review on appeal and the appellate court must give "due regard" to the trial court's opportunity to observe the witnesses and thereby make credibility assessments.

In Rule 183 cases, it is the STJ who is the original finder of fact and who observes the witnesses. In order for the due regard and clearly erroneous standards of Federal Rule of Civil Procedure 52(a) to be complied with, the STJ's report must be included in the record on appeal. Otherwise, the Courts of Appeals could be put in the untenable position of unwittingly upholding, as not clearly erroneous, findings that were not those of the trial judge. Similarly, the Courts of Appeals could unwittingly respect credibility determinations that were not those of the judge who observed the witnesses.

> If the appellate judges who review for correctness are denied information they would otherwise consider, if information is transmitted to them in a form which inhibits full perception of an important aspect of the case, or if the information is skewed, even the best-focused scrutiny will be misdirected and the most genuine consensus may rest on this misconception.

Robert S. Thompson & John B. Oakley, *From Information to Opinion in Appellate Courts: How Funny Things Happen on the Way Through the Forum*, 1986 Ariz. St. L.J. 1, 11 (1986); *cf. Dayton Board of Education v. Brinkman*, 443 U.S. 526, 534 n.8 (1979) (agreeing with dissenting Justice Stewart "that there is great value in appellate courts showing deference to the fact-finding of local trial judges.").

In addition, any approach other than including the STJ's report in the record on appeal would lead to different types of review under Federal Rule of Civil Procedure 52(a) depending on whether a Tax Court judge or STJ is the trier of fact. That is, if a Tax Court judge hears the case, the Court of Appeals will have in the record the

findings of fact of the trier of fact and can uphold them unless clearly erroneous and give due regard to that judge's opportunity to observe the witnesses. By contrast, if the STJ's report in a large case is not included in the record on appeal, the original findings of fact and credibility determinations of the STJ will not be available to the Court of Appeals.

This is not an infrequent issue, given that Judge Cudahy found over 880 Tax Court decisions since 1983 that involved a STJ report. *See Estate of Kanter*, 337 F.3d 833, 876 (7th Cir. 2003) (Cudahy, J., concurring in part and dissenting in part). In addition, STJs may be assigned large cases that are very fact-intensive. *See Freytag v. Commissioner*, 501 U.S. 868, 872 n.1 (1991) (describing the case as one that "involved one of the longest trials . . . in the tax court's history – 14 weeks of evidence, complex financial testimony, 9,000 pages of transcripts, 3,000-plus exhibits."). In fact, the Tax Court trial below, "consumed 28 days of trial time. There were 55 government witnesses. The transcript exceeded 5,000 pages." Cornish F. Hitchcock, *Public Access to Special Trial Judge Reports*, 93 Tax Notes 403, 404 (Oct. 15, 2001). Furthermore, it is the Chief Judge of the Tax Court who decides which large cases to assign to STJs, I.R.C. § 7443A(b), so the selection of cases for this procedure is not random. Assignment also is not subject to party consent. Given this context, a system that shields from Court of Appeals review the initial fact-finding in large cases presided over by STJs provides an unhealthy incentive for the assignment to STJs of controversial or fact-intensive cases.

Furthermore, Tax Court Rule 183 has its own "due regard" provision, applicable to the Tax Court. It provides that "[d]ue regard shall be given to the circumstance that

the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Tax Ct. R. 183(c). In order for this rule to be enforceable, the STJ's report must be included in the record on appeal.

As this Court has stated:

> the trial on the merits should be "the 'main event' . . . rather than a 'tryout on the road.'" *Wainwright v. Sykes*, 433 U.S. 72, 90 (1977). For these reasons, review of factual findings under the clearly-erroneous standard – with its *deference to the trier of fact* – is the rule, not the exception.
>
> When findings are based on determinations regarding the *credibility of witnesses, Rule 52(a) demands even greater deference to the trial court's findings*; for only the trial judge can be aware of the variations in demeanor and tone of voice that bear so heavily on the listener's understanding of and belief in what is said.

Anderson v. Bessemer City, 470 U.S. 564, 575 (1985) (emphasis added). The only way for a Court of Appeals to accord *any* deference at all to the findings of fact and credibility determinations of the trial judge in a Rule 183 case – or to evaluate whether the Tax Court has given proper regard to the STJ's position as trier of fact under its own rule – is for the STJ's report to be included in the record on appeal.

II. BECAUSE CONGRESS HAS PROVIDED FOR REVIEW OF TAX COURT DECISIONS TO THE SAME EXTENT AS DISTRICT COURT DECISIONS AND BECAUSE THE RECORD ON APPEAL IS A CRITICAL PART OF THAT REVIEW, THE FINDINGS OF FACT AND CONCLUSIONS OF THE TRIAL JUDGE, WHICH WOULD BE INCLUDED IN THE RECORD ON APPEAL OF A DISTRICT COURT TRIAL WITHOUT A JURY, CANNOT BE EXCLUDED FROM THE RECORD ON APPEAL OF A TAX COURT CASE

As noted above, § 7482(a) provides, in relevant part, that "[t]he United States Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . . ." I.R.C. § 7482(a)(1). This section was enacted in 1948 to overturn the holding of *Dobson v. Commissioner*, 320 U.S. 489 (1943), which had interpreted then-existing law, including the predecessor of § 7482(c)(1), as allowing only limited review of Tax Court decisions. *See* S. Rep. No. 80-1559, at 13 (1948); Harold Dubroff, *The United States Tax Court: An Historical Analysis* 381-82, 386 (1979).

The history of § 7482(a)(1) reflects Congress' intent to provide for appellate review of Tax Court (then Board of Tax Appeals) decisions that was no more limited than review of district court decisions, at least on questions of fact. A Senate Report refers to the provision as repealing the *Dobson* rule and thereby "mak[ing] decisions of the Tax Court on questions of fact reviewable if clearly

erroneous, as is now the case with similar decisions of the district courts," S. Rep. No. 80-1559, at 13 (1948), while the Committee on the Judiciary spoke more broadly:[3]

> From the time . . . appellate review [of Tax Court decisions] was established by the Revenue Act of 1926 until the *Dobson* decision in 1943, there had been no suggestion that the review of the Tax Court decisions was any more limited than the appellate review of decisions of the United States District Courts. . . . The Supreme Court in the *Dobson* case, however, created a new rule of law which would not permit even law questions to be reviewed unless they were clear-cut questions of law, and which would not permit any worth-while review of decisions of fact. . . .
>
> [The provision in the Senate bill] *restores to the circuit courts of appeal the power to review cases from the Tax Court in the same manner and to the same extent as it has power to review other cases* – whether tax cases or nontax cases

[3] In part because of ambiguity in the legislative history and in part because Congress retained the language of what is now § 7482(c)(1), which empowers a Court of Appeals to modify or reverse the Tax Court's decision if it "is not in accordance with law," there has been academic commentary to the effect that "[a]t a minimum . . . the language and history of the 1948 amendment leave the door open for the courts to construe the amendment as limited to providing a new standard for review of factual issues ('clearly erroneous') while retaining the *Dobson* standard for legal issues (entitled to 'great deference')." David F. Shores, *Deferential Review of Tax Court Decisions:* Dobson *Revisited*, 49 Tax Law. 629, 653 (1996). Nonetheless, "[f]or approximately the last 50 years, Tax Court decisions on questions of law have been subject to de novo review by the court[s] of appeals . . . ." David F. Shores, *Deferential Review of Tax Court Decisions: Taking Institutional Choice Seriously*, 55 Tax Law. 667, 667 (2002).

> – coming from a District Court in a case tried without a jury.

Views of the Committee on the Judiciary with Respect to Senate Amendments to H.R. 3214, reprinted in 94 Cong. Rec. 8501 (1948) (emphasis added); *see also Commissioner v. Duberstein*, 363 U.S. 278, 291 n.13 (1960) ("The purpose of the 1948 legislation was to remove from the law the favored position (in comparison with District Court and Court of Claims rulings in tax matters) enjoyed by the Tax Court under this Court's ruling in *Dobson v. Commissioner*, 320 U.S. 489.").

As the history of § 7482(a)(1) shows, it is a provision with substantive content. It is intended to provide both for meaningful appellate review of Tax Court decisions and for a particular kind of appellate review – review comparable to that afforded decisions in civil bench trials in district court, particularly on factual questions. In fact, this Court has cited § 7482(a) as requiring application of the "clearly erroneous" standard of review of Federal Rule of Civil Procedure 52(a) on appeal from Tax Court decisions, *Duberstein*, 363 U.S. at 291 & n.13, as discussed above, and in support of the important principle that "[t]he Tax Court's function and role in the federal judicial scheme closely resemble those of the federal district courts," *Freytag v. Commissioner*, 501 U.S. 868, 891 (1991).

A. The Contents of the Record on Appeal are Key for Appellate Review

Appellate review of the decision of a trial court is based on the record on appeal. *See* 20 *Moore's Federal Practice* § 310.02[1] (3d. ed. 1997) ("The contents of the

record as it is presented to the circuit court determine and limit the issues that may be addressed on appeal."); Cora M. Thompson, *Cyclopedia of Federal Procedure* § 61.02 (rev. 3d ed. 1994) ("A written or printed record is the basis of all ordinary modes of review by a higher court. Barring matters of which the court may take judicial notice, consideration of the court of review is confined to the record which is filed in the particular case.") (footnotes omitted); *Abatino v. United States*, 750 F.2d 1442, 1445 (9th Cir. 1985) ("The Court of Appeals' review of a District Court's order must be made on the basis of the record on appeal, which comes up from the district court.").

Thus, the contents of the record on appeal determine the parameters of appellate review. *Cf. Jackson v. United States*, 131 F.2d 606, 607 (8th Cir. 1942) ("In addition to the record on appeal, we have been furnished by the Government with certain documents explanatory of what occurred in the court below. We cannot, of course, concern ourselves with anything which does not appear in the record."); *cf. Hughes v. Wendel*, 317 U.S. 134, 134 (1942) (*per curiam*) (dismissing appeal where "[t]he record . . . [did] not set forth appellant's lease, and the incomplete summary of it contained in her pleading [was] not adequate to enable [the Court] to determine what her rights may be."); *James Petroleum Corp. v. Commissioner*, 331 F.2d 344, 346 (10th Cir. 1964) ("The Internal Revenue Code of 1954, § 7482, states that the Court of Appeals shall review the decisions of the Tax Court in the same manner and to the same extent as the decisions of the District Courts. This requires complete findings of fact to demonstrate the basis for decision.").

> The appeal record is virtually as old as the appellate process itself. Unless the appellate court is to act de novo and disregard all that went on in the trial court, *it is essential that the appellate court be able to determine what occurred in the trial court.* This is particularly important when the purpose of appellate review is, as it is in most appeals, error correction . . . .
>
> The effect of [various rules regarding the record] is to make *the record on appeal crucial to the appellate process.*

Robert J. Martineau, *Modern Appellate Practice: Federal and State Civil Appeals* § 8.1 (1983) (footnotes omitted); *cf. Commissioner v. McCoy*, 484 U.S. 3, 6 (1987) (citing § 7482(a) and (c)(1) and stating, "[i]t follows that in reviewing a Tax Court decision, the duty of the court of appeals is to consider whether the Tax Court committed error.").

Because of the key role of the record on appeal in appellate review, for Tax Court decisions to be afforded the review required by § 7482(a)(1), a document that would be part of the record on appeal of a district court bench trial must be included in the record on appeal of a Tax Court case. Moreover, the Federal Rules of Appellate Procedure provide that *the same rule providing the content of the record on appeal in District Court cases applies to appeals from the Tax Court. See* Fed. R. App. P. 13(d)(1) (providing, in part, that Rule 10, relating to the record on appeal, applies to appeals from Tax Court cases and that "[r]eferences in [that rule] . . . to the district court and district clerk are to be read as referring to the Tax Court and its clerk.").

B. The Record on Appeal from a District Court Case Includes the Original Findings of Fact, Including Those of an Inferior Officer who Heard a Dispositive Matter or Conducted the Trial

Federal Rule of Appellate Procedure 10(a) provides a list of the items that constitute the record on appeal in a district court case:

> (1) the original papers and exhibits filed in the district court;
>
> (2) the transcript of proceedings, if any; and
>
> (3) a certified copy of the docket entries prepared by the district clerk.

Fed R. App. P. 10(a).[4]

> The first part, *original papers, is broadly defined* to include all documents filed with, and presented to, the district court. *The term includes documents presented and filed, whether by a party or by the district judge.* . . . Examples of documents that are classified as original papers include: . . .
>
> – court memoranda . . . ;

[4] Federal Rule of Appellate Procedure 10 also authorizes a truthful agreed statement of the parties "showing how the issues presented by the appeal arose and were decided in the district court. . . . together with any additions that the district court may consider necessary to a full presentation of the issues on appeal . . . approved by the district court and . . . certified to the court of appeals as the record on appeal" to be substituted for the record on appeal defined in Rule 10(a). Fed. R. App. P. 10(d).

> – master's reports . . . ;
>
> – findings of fact and conclusions of law;
>
> – opinions of the court; [and]
>
> – judgments . . . .

20 *Moore's Federal Practice* § 310.10[1] (3d. ed. 1997) (emphasis altered) (footnotes omitted).

Thus, in district court, not only are papers filed by the parties included in the record on appeal, but documents filed by the court – such as memoranda, findings of fact, reports, and opinions – are included as well. *See, e.g., Brown v. United States*, 277 F.2d 201, 202 (8th Cir. 1960) ("detailed memorandum" written by the judge was one of the "original papers of the District Court" and was furnished to Court of Appeals); *United States v. Certain Interests in Property*, 296 F.2d 264, 268 (4th Cir. 1961) (quoting from "unreported statement of . . . findings of fact and conclusions" prepared by district court judge in addition to his reported opinion).

> Even the Commissioner, at oral argument [in *Estate of Kanter*], acknowledged that in *every milieu except that of the Tax Court, the document containing the findings or recommendations of the official conducting the trial are available to a court reviewing the operative decision*. This includes, for example, the report of a federal magistrate judge to a district court responsible for a decision.

Estate of Kanter v. Commissioner, 337 F.3d 833, 874 (7th Cir. 2003) (Cudahy, J., concurring in part and dissenting in part) (emphasis added).

Tax Court STJs are analogous to magistrate judges; in district court, magistrate judges may make findings and recommendations, as well as conduct trials. *See Estate of Smith v. Commissioner*, 638 F.2d 665, 669 (3d Cir. 1981) ("As we see it, the special trial judge acts in a capacity not dissimilar to that of a magistrate in district court."). "[M]agistrate judges and special trial judges enjoy the same constitutional status as 'inferior officers.'" Kathleen Pakenham, *You Better Shop Around: The Status and Authority of Specialty Trial Judges in Federal Tax Cases*, 103 Tax Notes 1527, 1532 (June 21, 2004).

Although district court magistrate judges may be assigned a variety of matters, *see* 28 U.S.C. § 636, nonconsensual district court use of magistrate judges in "dispositive" pretrial matters (those encompassed by 28 U.S.C. § 636(b)(1)(B)) is most analogous to the Tax Court's use of STJs in Rule 183 cases because, in those matters, as in Rule 183 cases, (1) the judicial officer (magistrate or STJ) presides over proceedings that may dispose of the case; (2) consent of the parties is not required for the assignment of the magistrate or STJ to the matter; and (3) the magistrate or STJ makes a recommendation to a judge, not a decision. *Compare* Tax Ct. R. 183 *with* 28 U.S.C. § 636(b)(1). In addition, a magistrate's report and recommendation on a dispositive matter is analogous to a STJ's report under Rule 183. *See Klein v. United States*, 94 F. Supp. 2d 838, 847 (E.D. Mich. 2000) ("Like a federal magistrate judge's report and recommendation to the district court, a Special Trial Judge's proposed findings and opinion become those of the Tax Court once adopted by the presiding Tax Court judge.") (*citing Freytag*, 501 U.S. at 873); *cf. Estate of Kanter*, 337 F.3d at 874 (Cudahy, J., concurring in part and dissenting in part) (referring by analogy in Tax Court

Rule 183 case to "the report of a federal magistrate judge to a district court responsible for a decision.").

The magistrate's report and recommendation in a dispositive matter are included in the record on appeal. In dispositive matters, "the magistrate shall *file his proposed findings and recommendations . . . with the court . . . .*" 28 U.S.C. § 636(b)(1)(C) (emphasis added). Documents filed with the court constitute part of the record on appeal under Federal Rule of Appellate Procedure 10. *See* Fed. R. App. P. 10(a)(1). Federal Rule of Civil Procedure 72 adds that in dispositive pretrial matters heard by a magistrate without consent of the parties, "[a] record shall be made of all evidentiary proceedings before the magistrate judge, and a record may be made of such other proceedings as the magistrate judge deems necessary. The magistrate judge shall *enter into the record* a recommendation for disposition of the matter, including proposed findings of fact when appropriate." Fed. R. Civ. P. 72(b) (emphasis added).

Of course, in Rule 183 cases in Tax Court, the STJ may conduct the entire trial. *See* Tax Ct. R. 183(a). In those cases in which a magistrate judge conducts a district court trial (by consent of the parties) and enters judgment, "an aggrieved party may appeal directly to the appropriate United States court of appeals from the judgment of the magistrate in the same manner as an appeal from any other judgment of a district court." 28 U.S.C. § 636(c)(3); *see also Roell v. Withrow*, 538 U.S. 580, 585 (2003); Fed. R. Civ. P. 73(c). "When functioning in this capacity, magistrate judges are appropriately viewed as proxies for district judges . . . ." A.J. Stephani & Glen Weissenberger, *Federal Civil Procedure 2003 Litigation Manual* 536 (2002). No other judge need be involved in the case at the district court level, so the magistrate judge's findings are

necessarily those subject to review on appeal and Federal Rule of Appellate Procedure 10(a) should apply to determine the contents of the record on appeal, just as it does in other district court cases. *See* Fed. R. App. P. 10(a); *see also Madison v. Parker*, 104 F.3d 765, 767 (5th Cir. 1997) ("We review a judgment rendered by a magistrate judge just as we do a judgment rendered by a district judge.") (*citing* 28 U.S.C. § 636(c)(3)).

Thus, in district court, original findings of fact, including those of magistrate judges, who are analogous to STJs, are included in the record on appeal. Judge Cudahy stated in his separate opinion in *Estate of Kanter*, "in every milieu except that of the Tax Court, the document containing the findings or recommendations of the official conducting the trial are available to a court reviewing the operative decision." *Estate of Kanter*, 337 F.3d at 874 (Cudahy, J., concurring in part and dissenting in part). Most importantly "[t]his includes . . . the report of a federal magistrate judge to a district court responsible for a decision." *Id.* (Cudahy, J., concurring in part and dissenting in part). Given the similarities between the district court's report and recommendation procedure and the Tax Court's procedure in Rule 183 cases, the omission of the STJ's report from the record on appeal violates § 7482 because it prevents appellate review of the Tax Court decisions "to the same extent as decisions of the district courts in civil actions tried without a jury," I.R.C. § 7482(a)(1).

C. Like the District Courts, the Tax Court Cannot Opt to Omit Case Documents from the Record on Appeal

"[U]nder [Federal] Rule [of Appellate Procedure] 10(a), all of the original papers and exhibits filed in the district court are a part of the record on appeal whether or not brought before [the appellate] court." *Chapman v. Rudd Paint & Varnish Co.*, 409 F.2d 635, 638 (9th Cir. 1969). "[A]s a matter of law the district court's record now constitutes the record on appeal." David G. Knibb, *Federal Court of Appeals Manual* § 27.1 (3d ed. 1997). Moreover, "[i]t is not the type of paper submitted but rather the fact of filing which determines whether a particular item will be included in the record." *International Business Machines Corp. v. Edelstein*, 526 F.2d 37, 45 (2d Cir. 1975).

Because the fact of filing a document with the court is the linchpin of inclusion in the record on appeal under Federal Rule of Appellate Procedure 10(a), a court's refusal to file a document raises an issue of usurpation of power. *See id.* In *International Business Machines Corp.*, the Court of Appeals for the Second Circuit stated, "[t]he [trial] judge's refusal to file IBM's papers . . . raise[s] such issue [of usurpation of power], because the *Petitioner is thereby prevented from making a record for purposes of appeal*." *Id.* (emphasis added).

The court added:

> The policy that it is the appealing parties, and not the trial court, who control the issues to be presented on appeal has been embodied in federal practice since the Federal Rules were adopted in 1938. . . .

> On the basis of this policy, *district courts have refrained from exercising any degree of control over the contents of the trial record*, . . . even where parties have petitioned the trial court to exclude certain items from the record.

Id. at 45-46. The court therefore held:

> Since Petitioner has no other means of presenting its arguments to the appellate court – whether as appellant or appellee – save by making the necessary record at the trial level, Judge Edelstein's refusal to file petitioner's motions has constituted an *impermissible interference with petitioner's right to make the record it chooses for purposes of appeal*.

Id. at 46; *cf. United States v. Forness*, 125 F.2d 928, 932 (2d Cir. 1942) (interpreting prior Federal Rule of Civil Procedure 75(h), which governed the record on appeal, as precluding the district court judge from striking certain affidavits from the record, and finding that the rule "permit[ted] him only to add to the record, or to correct it.").

The policy reflected in the Second Circuit's opinion in *International Business Machines Corp.* applies with equal force to the Tax Court. Section 7482(a)(1) provides for review of Tax Court decisions to the same extent as review of district court decisions, and, as explained above, the record on appeal is the linchpin of that review. Furthermore, Federal Rule of Appellate Procedure 10, which was applied in *International Business Machines Corp.*, applies to the Tax Court, as well. *See* Fed. R. App. P. 13(d)(1).

Thus, the Tax Court should not be able to refuse to file a document, so as to make it part of the record, any more

than a district court can. Yet, the Tax Court has done the practical equivalent of that. The Tax Court previously provided complete transparency in cases heard under Rule 183, including service of a copy of the STJ's report on each party and an opportunity to file exceptions to the report with respect to both fact and law. *See* Tax Ct. R. 182(b), (c), 60 T.C. 1149 (1973) (repealed 1984). The prior Tax Court rule also required the STJ to *file* his report, *see id.*, which resulted in its inclusion in the record on appeal under the Federal Rules of Appellate Procedure. *See* Leandra Lederman, *Transparency and Obfuscation in Tax Court Procedure*, 102 Tax Notes 1539, 1540 & n.10 (Mar. 22, 2004).

In 1983, the Tax Court amended its rule without indicating that there were any problems under the existing procedure or otherwise explaining its motivation. *See* Tax Ct. R. 183 note on amendments to rule, 81 T.C. 1069-70 (1983) (amending and renumbering former Rule 182). All that the 1983 note to Rule 183 states with respect to this change is:

> The prior provisions for service of the Special Trial Judge's report on each party and for the filing of exceptions to that report have been deleted. The prior provision for oral argument upon a motion of a party also has been deleted. However, par. (c) provides that the Division to which the case is assigned may direct the filing of additional briefs, receive further evidence, or direct oral argument.

Id., 81 T.C. 1070 (1983).

> There is no public indication why the Tax Court rules and procedures were changed in 1983 to the current system that disadvantages those appealing Tax Court decisions. And, of course, an

> appellate-style procedure such as that typical in all other areas of federal administrative adjudication would facilitate challenges, whether made by the taxpayer or by the Commissioner. The previous procedure may well have been abrogated for exactly this reason.

Estate of Kanter, 337 F.3d at 879 (Cudahy, J., concurring in part and dissenting in part). Given the requirements of § 7482(a)(1), the Tax Court cannot choose to omit from the record on appeal a document, such as the original findings of fact of the trial judge, that would be part of the record on appeal in a district court case.

III. INCLUSION OF THE SPECIAL TRIAL JUDGE'S REPORT IN A TAX COURT RULE 183 CASE IN THE RECORD ON APPEAL IS CONSISTENT WITH THE POLICY OF TRANSPARENCY CONGRESS MANIFESTED WHEN IT CREATED THE BOARD OF TAX APPEALS

In creating the predecessor of the Tax Court, the Board of Tax Appeals, Congress focused on a desire for transparency in its proceedings. For example, one Representative stated:

> I believe that the publicity features as contained in the bill are wholesome, are necessary, and while it may cause embarrassment and inconvenience, perhaps, to an individual here and there, it is for the good of all the taxpayers . . . . No fault can seriously be found in a provision which requires the proceedings of the board of appeals to be public. Let us be frank about that. . . . *The board of appeals and the publicity placed upon its activities are the result of a vicious secrecy system which has grown up in the Treasury Department under the present law.*

65 Cong. Rec. 9549 (1924) (statement of Rep. LaGuardia) (emphasis added). Congress refused to countenance such secrecy when it created the Board of Tax Appeals; the statute creating the Board of Tax Appeals required publicity in the proceedings of the Board and publication of its reports. *See* Harold Dubroff, *The United States Tax Court: An Historical Analysis* 65 & n.96 (1979).

The policy Congress manifested in favor of transparency in Tax Court proceedings continues to be reflected in current law. *See* I.R.C. §§ 7458 ("Hearings before the Tax Court and its divisions shall be open to the public . . . ."); 7461(a) ("Except as provided in subsection (b), all reports of the Tax Court and all evidence received by the Tax Court and its divisions, . . . shall be public records open to the inspection of the public."). The Tax Court's practice in Rule 183 cases is inconsistent with that policy. Judge Cudahy has argued:

> The fact is that this entire process of the Tax Court [in Rule 183 cases] appears designed to extract the efficiencies involved in designating cases to be heard by STJs without having to bear any of the procedural costs traditionally associated with this kind of adjunct decision making (e.g., transparency). I do not believe that the STJ's ultimate assent to the final opinion of the Tax Court is protection enough to the parties.

Estate of Kanter v. Commissioner, 337 F.3d 833, 887-88 (7th Cir. 2003) (Cudahy, J., concurring in part and dissenting in part).

Moreover, the "vicious" nature of a secret system is that it enables its actors to avoid accountability for their actions. Appellate review is a critical part of that accountability.

> Assuming that a judge deciding a case – like anyone making a decision – would not relish the thought of being told that she was wrong, the possibility of having her decision reversed on appeal imposes a cost and becomes a consideration in rendering judgments. In theory, lower-court judges, as a result, would be more likely to choose outcomes solidly based on legal justifications traceable to past decisions or statutes. Thus, appellate review enhances the rationality of lower court decision making by introducing the prospect of institutional censure: certain judicial choices can be constrained by the fact that some options have already been ruled out, or are likely to be ruled out, by a higher court.

David Frisch, *Contractual Choice of Law and the Prudential Foundations of Appellate Review*, 56 Vand. L. Rev. 57, 85 (2003).

Furthermore, appellate oversight of Article I courts by Article III courts may be constitutionally required. The plurality opinion in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), stated, "when Congress assigns [public rights] matters to administrative agencies, or to legislative courts, it has generally provided, and we have suggested that it may be required to provide, for Art. III judicial review." *Id.* at 69 n.23 (*citing Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S. 442, 455 n.13 (1977)). Professor Richard Fallon has argued, "the central claim of my appellate review theory [is thus]: adequately searching appellate

review of the judgments of legislative courts and administrative agencies is both necessary and sufficient to satisfy the requirements of article III." Richard H. Fallon, Jr., *Of Legislative Courts, Administrative Agencies, and Article III*, 101 Harv. L. Rev. 915, 918 (1988); *see also* Deborah A. Geier, *The Tax Court, Article III, and the Proposal Advanced by the Federal Courts Study Committee: A Study in Applied Constitutional Theory*, 76 Cornell L. Rev. 985, 1026-27 (1991) (arguing that "article III appellate review" of the decisions of a legislative court such as the Tax Court is necessary but not sufficient).

Omission of the STJ's report from the record on appeal is inconsistent with these policies of transparency, oversight, and accountability. In addition, keeping the report secret is inconsistent with Congress' intent to make Tax Court proceedings public. Furthermore, in a Rule 183 case in Tax Court, only the appellate courts can oversee the reviewing judge's actions on the STJ's report. Excluding the report from the record on appeal eliminates that oversight, thereby precluding meaningful appellate review by an Article III court. *See Estate of Kanter*, 337 F.3d at 888 (argument of Judge Cudahy that "by eventually making the STJ's report public (and part of the available record of the Tax Court on appeal), [the Court of Appeals] will have an opportunity to conduct meaningful appellate review.") (Cudahy, J., concurring in part and dissenting in part).

> The correct finding, as near as may be, of the facts of a law suit is fully as important as the application of the correct legal rules to the facts as found. An impeccably "right" legal rule applied to the "wrong" facts yields a decision which is as

> faulty as one which results from the application of the "wrong" legal rule to the "right" facts. . . .
>
> . . . As fact-finding is a human undertaking, it can, of course, never be perfect and infallible. For that very reason every effort should be made to render it as adequate as it humanly can be.

United States v. Forness, 125 F.2d 928, 942-43 (2d Cir. 1942) (footnotes omitted).

CONCLUSION

The judgments of the United States Courts of Appeals for the Seventh Circuit and the Eleventh Circuit should be vacated and the cases remanded so that the report of Special Trial Judge Couvillion can be included in the record on appeal.

Respectfully submitted,

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CLAUDE M. BALLARD, ET UX., *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

ESTATE OF BURTON W. KANTER, ET AL., *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Writs of Certiorari to the United States Courts of Appeals for the Seventh and Eleventh Circuits

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IN THE

Supreme Court of the United States

No. 03-184

CLAUDE M. BALLARD, ET UX.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 03-1034

ESTATE OF BURTON W. KANTER, ET AL.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writs of Certiorari to the United States Courts of Appeals for the Seventh and Eleventh Circuits

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BRIEF AMICUS CURIAE OF THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS LEGAL FOUNDATION IN SUPPORT OF PETITIONERS

STATEMENT OF INTEREST OF AMICUS CURIAE[1]

The National Federation of Independent Business Legal Foundation ("NFIB Legal Foundation")—a nonprofit public interest law firm established to protect the rights of America's small business owners—is the legal arm of the National Federation of Independent Business ("NFIB"), the Nation's oldest and largest organization dedicated to representing the interests of small business owners throughout all 50 states. The approximately 600,000 NFIB members own a wide variety of small businesses, including family farms, neighborhood retailers, service companies, and technology manufacturers.

The secretive process employed by the Tax Court is of concern to the NFIB Legal Foundation and the members of the NFIB. That process, and the court of appeals decisions below upholding it, raise serious questions about the actual and perceived fairness of Tax Court adjudications and the ability of small businesses effectively to contest disputes over tax liability in that court. The NFIB Legal Foundation supports the simplification of the process for determining and complying with tax obligations. The Tax Court's secretive handling of STJ reports, however, makes the process for adjudicating tax disputes more complicated and less transparent.

The NFIB Legal Foundation, or the NFIB itself, has filed briefs *amicus curiae* in prior cases of this Court affecting the interests of small business owners at both the petition and merits stages. *See Walters* v. *Metropolitan Educ. Enters.*,

[1] This brief was authored by Hogan & Hartson L.L.P., which serves as counsel for *amicus curiae* in this case. Pursuant to this Court's Rule 37.6, we note that Hogan & Hartson has represented the *Kanter* petitioners in other, non-litigation matters. Hogan & Hartson has not served as counsel for those parties in this case, however, and none of the Hogan & Hartson attorneys who have represented the Kanter family authored any part of this brief. Furthermore, no person or entity other than *amicus curiae* or Hogan & Hartson made a monetary contribution to the preparation and submission of this brief.

Inc., 519 U.S. 202 (1997) (merits stage); *Pierce* v. *Underwood*, 487 U.S. 552 (1988) (same); *Marshall* v. *Barlow's Inc.*, 436 U.S. 307 (1978) (same); *Deaton* v. *United States*, 124 S. Ct. 1874 (2004) (petition stage); *McNab* v. *United States*, 124 S. Ct. 1406 (2004) (same); *Gross* v. *Commissioner*, 537 U.S. 827 (2002) (same); *Walters* v. *Metropolitan Educ. Enters., Inc.*, 516 U.S. 1171 (1996) (same).

This brief is filed with the written consent of all parties pursuant to this Court's Rule 37.3(a); the requisite consent letters have been filed with the Clerk.

INTRODUCTION

The central issue in this case is whether the United States Tax Court's secretive handling of reports filed by its Special Trial Judges under Tax Court Rule 183 comports with the Due Process Clause of the Fifth Amendment.

Congress has authorized the Chief Judge of the Tax Court to "appoint Special Trial Judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court." 26 U.S.C. § 7443A(a). Rule 183 provides that, following the conduct of a trial by an STJ, the STJ "shall submit a report, including findings of fact and opinion, to the Chief Judge," who will assign the case to a Judge or Division of the Tax Court. Tax Ct. R. 183(b). The rule also provides that the STJ's report—including the findings of fact therein—"shall be presumed to be correct," Tax Ct. R. 183(c), and given deference by the Judge or Division to which it is assigned. *See id.* ("Due regard shall be given to the circumstance that the [STJ] had the opportunity to evaluate the credibility of witnesses"); *see also Freytag* v. *Commissioner*, 501 U.S. 868, 874 n.3 (1991) (STJ's factual findings are reviewed by a Tax Court Judge under a "deferential standard"). Subject to those constraints, the Judge or Division to which the case is assigned may adopt, modify, or reject the STJ's report in whole or in part; receive additional evidence; order oral argument; or recommit the report with instructions. *See* Tax Ct. R. 183(c).

The practice of the Tax Court is to withhold the STJ's report from view. Neither the taxpayer nor a reviewing court of appeals ever sees the STJ's report, and that report is not made part of the record of the Tax Court's decision. And in those cases in which the Tax Court rejects the STJ's "presumed to be correct" findings, that fact goes undisclosed. Instead, the STJ prepares a revised report which the Tax Court adopts as its opinion—without ever revealing that the STJ's original findings were changed. As explained below, this secretive process is inconsistent with the Constitution's assurance of due process of law.

SUMMARY OF ARGUMENT

The Tax Court's failure to make the STJ's report available to a reviewing court of appeals violates the right to due process on appeal. The courts of appeals review decisions of the Tax Court for clear error, and the central feature of clear-error review is deference to the credibility judgments of the factfinder. Consistent with that approach, Tax Court Rule 183(c) provides that the STJ's findings of fact are "presumed to be correct" and that "[d]ue regard" shall be given to the STJ's determinations of witness credibility. The Tax Court's secretive process, however, impedes clear-error review by preventing the court of appeals from assessing whether the Tax Court gave proper deference to the STJ's factfinding and credibility determinations.

Due process also requires disclosure of the STJ's report on appeal because that document has legal effect. Under Rule 183, the STJ is required to prepare a report, and the Tax Court is required both to presume the correctness of the STJ's findings of fact and to give deference to the STJ's credibility determinations. The Rule 183 report thus has a legally-operative effect upon the Tax Court's ultimate decision. Underscoring this conclusion is *Freytag*, in which this Court held that STJs exercise significant governmental authority and rejected the Commissioner's contrary argument that STJs are mere "aides" of the Tax Court.

The three-part test of *Mathews* v. *Eldridge*, 424 U.S. 319 (1976), confirms that, as a matter of due process, STJ reports must be available to a reviewing court of appeals. First, the private interests at stake in a Tax Court case clearly are significant; in this case, for example, a taxpayer was found liable for civil tax fraud. Second, the Government has no readily apparent interest in denying to a reviewing court of appeals an STJ's report—which Tax Court rules already require STJs to prepare and submit to the Tax Court. Third, the Tax Court's refusal to release the STJ's report increases the risk of an erroneous deprivation of the taxpayer's property interest by impairing the court of appeals' ability properly to review the facts found by the Tax Court.

Transparency and openness in the adjudicatory process are essential to the actual and perceived fairness of the judicial system. Yet the Tax Court refuses to disclose the conclusions of its initial factfinders. In so doing, the Tax Court stands alone. Unlike STJ reports, the initial findings of magistrate judges, bankruptcy judges, and administrative law judges are part of the record on review.

The serious due process question raised by the Tax Court's secretive process can, however, be avoided by construing 26 U.S.C. §§ 7459(b) and 7461(a) to require disclosure of STJ reports. The former states that "all reports of the Tax Court" are "public records" while the latter requires the Tax Court to "report in writing all its findings of fact, opinions, and memorandum opinions." Pursuant to the doctrine of constitutional doubt, these statutes should be construed to mandate disclosure of the STJ's report, thus obviating the substantial issue of due process that would otherwise arise from the Tax Court's practice of withholding those reports from reviewing courts of appeals.

ARGUMENT

I. APPELLATE REVIEW OF TAX COURT DECISIONS WITHOUT ACCESS TO THE STJ'S REPORT VIOLATES DUE PROCESS.

The Due Process Clause of the Fifth Amendment guarantees that "[n]o person shall be * * * deprived of life, liberty, or property, without due process of law." U.S. Const., amend. V. "[T]he Due Process Clause, like its forbear in the Magna Carta, was intended to secure the individual from the arbitrary exercise of the powers of government." *Daniels* v. *Williams*, 474 U.S. 327, 331 (1986) (internal citation and quotation marks omitted). "By requiring the government to follow appropriate procedures when its agents decide to 'deprive any person of life, liberty, or property,' the Due Process Clause promotes fairness in such decisions." *Id.*

"Because exaction of a tax constitutes a deprivation of property," procedures for the adjudication of tax liability must "satisfy the commands of the Due Process Clause." *McKesson Corp.* v. *Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990). Accordingly, a federal taxpayer, whether an individual or a business, has a constitutional right to a fair process for resolving tax disputes with the Internal Revenue Service. *See id.* at 39 (government must afford taxpayers "a fair opportunity to challenge the accuracy and legal validity of their tax obligation"); *Turner* v. *Wade*, 254 U.S. 64, 67-68 (1920) (taxpayer entitled to adequate process for challenging "the validity of a tax and the amount thereof").

Like the procedures governing the conduct of a trial or other initial level of adjudication, "the procedures used in deciding appeals must comport with the demands" of the Due Process Clause. *Evitts* v. *Lucey*, 469 U.S. 387, 393 (1985). Although there may be no constitutional right to appeal the decisions of the Tax Court, because Congress determined that taxpayers should have a statutory right to do so, *see* 26 U.S.C. § 7482(a)(1), the Tax Court cannot utilize a process that forecloses meaningful appellate review consistent with

due process. And as explained below, the Tax Court's refusal to include the STJ's report in the record on appeal precludes fair and accurate appellate review.

A. Appellate Review For Clear Error Requires Access To The STJ's Report.

The twelve regional courts of appeals review decisions of the Tax Court "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." 26 U.S.C. § 7482(a)(1); *see Freytag*, 501 U.S. at 891. Thus, courts of appeals review the Tax Court's factual findings for clear error. *Commissioner* v. *Duberstein*, 363 U.S. 278, 290-291 (1960); *see, e.g.*, *Andantech L.L.C.* v. *Commissioner*, 331 F.3d 972, 976 (D.C. Cir. 2003) (citing *Duberstein*); *Ballantyne* v. *Commissioner*, 341 F.3d 802, 807 (8th Cir. 2003) (same).[2]

The cornerstone of clear-error review is deference to the initial factfinder's opportunity to observe witnesses first-hand and to make credibility determinations. As this Court has explained, "[t]rial judges have the unique opportunity to consider the evidence in the living courtroom context, while appellate judges see only the cold paper record." *Gasperini* v. *Center for Humanities, Inc.*, 518 U.S. 415, 438 (1996) (internal citations and quotation marks omitted). "Face to face with living witnesses the original trier of fact holds a position of advantage" from which, in the case of the STJ, both the Tax Court Judge and appellate judges "are excluded." *United States* v. *Oregon State Med. Soc'y*, 343 U.S. 326, 339 (1952) (quotation marks and citation omitted); *see also Holiday* v. *Johnson*, 313 U.S. 342, 352 (1941) ("One of the essential elements of the determination of crucial facts is the weighing and appraising of testimony.").

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[2] " 'A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' " *Duberstein*, 363 U.S. at 291 (quoting *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948)).

When findings are based on determinations regarding the credibility of witnesses, the appellate court owes "even greater deference to the trial court's findings; for only the trial judge can be aware of the variations in demeanor and tone of voice that bear so heavily on the listener's understanding of and belief in what is said." *Anderson* v. *City of Bessemer City, N.C.*, 470 U.S. 564, 575 (1985) (citing *Wainwright* v. *Witt*, 469 U.S. 412 (1985)); *see also Webb* v. *Commissioner*, 394 F.2d 366, 380 (5th Cir. 1968) (noting the importance of observation of witness in Tax Court proceeding and deferring to the "benefit of live testimony where the demeanor of the witnesses would be gauged and evaluated").

This Court has stressed that determining "the weight and credibility of the evidence is the special province of the trier of fact." *Inwood Labs., Inc.* v. *Ives Labs., Inc.*, 456 U.S. 844, 856 (1982). Moreover, "[t]he rationale for deference to the original finder of fact is not limited to the superiority of the trial judge's position to make determinations of credibility. The trial judge's major role is the determination of fact, and with experience in fulfilling that role comes expertise." *Anderson*, 470 U.S. at 574-575.

In requiring that the STJ's factfinding shall be "presumed to be correct" and insisting upon "[d]ue regard" for the STJ's credibility determinations, Tax Court Rule 183(c) mirrors the standard for appellate review of findings of fact from district courts. Federal Rule of Civil Procedure 52(a) states that, in reviewing a trial judge's factual findings, "due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses" and provides that such findings shall be reviewed only for clear error. *See Inwood Labs.*, 456 U.S. at 855 (Rule 52(a) "recognizes and rests upon the unique opportunity afforded the trial court judge to evaluate the credibility of witnesses and to weigh the evidence.") (citing *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969)).[3]

[3] The importance of seeing a witness in making a credibility determination is also reflected in Federal Rule of Civil Procedure 63, which provides that when a judge is no longer able to proceed with a hearing or trial that has commenced, the successor judge shall recall any witness whose testimony is material and disputed at the request of a party.

Disregarding this Court's cases and pronouncements on the importance of credibility determinations and the critical vantage point of the initial factfinder in making credibility determinations—as well as its own rule—the Tax Court refuses to permit appellate courts to review the STJ's report. In so doing, the Tax Court precludes a constitutionally proper appeal because the centerpiece of clear-error review is deference to the credibility determinations and findings of the judicial officer who actually observed the witnesses. Due to the Tax Court's secretive process, an appellate court is left to review a credibility finding with the same degree of deference whether that finding was made by the Tax Court based on a cold record or by the STJ who presided over the trial. The Tax Court's decision to keep the STJ report secret also prevents an appellate court from determining if the Tax Court followed its own rules. Due process requires the Tax Court to follow its self-imposed rules and to create a record adequate to confirm whether it has done so. *See Giacco* v. *State of Pennsylvania*, 382 U.S. 399, 403 (1966) ("Certainly one of the basic purposes of the Due Process Clause has always been to protect a person against having the Government impose burdens upon him except in accordance with the valid laws of the land."). Only when the record for appellate review includes the findings of the initial factfinder, instead of merely those findings as filtered through a Tax Court Judge, can appellate review be fair and meaningful.

The refusal of the Tax Court to permit appellate court access to the STJ report implicates due process in two ways. First, even though due process mandates that factfinding not take place by proxy, the Tax Court Judge (who has not heard the witnesses) may, as alleged in this case, overturn the STJ's findings and credibility judgments. The Tax Court's secret process does not permit the appellate court to evaluate that reversal. Second, the Tax Court Judge may simply accept the

STJ's findings without undertaking the review required by Tax Court Rule 183(c). *Cf. Erhard* v. *Commissioner*, 46 F.3d 1470, 1476 (9th Cir.) ("Indeed, permitting the litigants to file objections to the special judge's report might well decrease the danger that the tax court will simply endorse the report without review.") (citation omitted), *cert. denied*, 516 U.S. 930 (1995). Either of these alternatives offends due process.

In order to review the Tax Court's factual findings for clear error, the appellate court must know the genesis of those factual findings. Although the Tax Court opinion states that it "agrees with and adopts the opinion of the Special Trial Judge" (App. to *Kanter* Pet. at 98a), and the STJ's *opinion* contains findings of fact, those findings may completely reverse the initial findings of fact that Tax Rule 183(b) requires to be contained in the STJ's *report*. And by keeping the original STJ report under wraps, neither the individual taxpayer nor the appellate court knows whether the crucial factual determinations on credibility and other issues contained in the Tax Court-adopted STJ opinion are the same or different from the factual findings in the STJ's report. If the findings are different, neither the taxpayer nor the appellate court knows if or how the Tax Court complied with the mandate of Tax Court Rule 183(c) to give "[d]ue regard" to the fact that the STJ "had the opportunity to evaluate the credibility of witnesses" and that the STJ's findings of fact in the report "shall be presumed to be correct." Tax Ct. R. 183(c). While the Tax Court opinion gives the impression that the STJ opinion is the STJ report,[4] there is simply no way to know whether, how, and why the Tax Court opinion modifies or reverses the factual findings in the STJ report

[4] In fact, both Courts of Appeals in the underlying cases specifically assumed that the STJ report and the STJ opinion were the same document. *See Ballard* v. *Commissioner*, 321 F.3d 1037, 1040 (11th Cir. 2003) ("Judge Dawson issued the opinion of the Tax Court in which the Tax Court both approved of and adopted Special Trial Judge Couvillion's *report*.") (emphasis added); *Estate of Kanter* v. *Commissioner*, 337 F.3d 833, 840-841 (7th Cir. 2003).

without access to the report itself. Appellate review on such terms is inadequate. *Cf. West Ohio Gas Co.* v. *Public Utils. Comm'n of Ohio*, 294 U.S. 63, 69 (1935).[5]

Because no Tax Court Judge is present at a trial before an STJ, the STJ is the exclusive finder of fact with respect to evaluating the credibility of witnesses. Rule 183(c) indicates that in the Tax Court, as in every other adjudicative forum, an initial factfinder's credibility assessments should not be second-guessed by those who were not present. *See Morgan* v. *United States*, 298 U.S. 468, 481 (1936) ("The one who decides must hear"). Live testimony provides the STJ access to nuances in a witness's physical reactions, demeanor, and tone of voice that cannot be gleaned from merely reading the transcript. In *Goldberg* v. *Kelly*, 397 U.S. 254 (1970), in which the Court evaluated a procedure that prevented welfare recipients from appearing personally before the official who actually determined eligibility, the Court said that "[p]articularly where credibility and veracity are at issue, * * * written submissions are a wholly unsatisfactory basis for decision." *Id.* at 269. Likewise, the cold record is a wholly unsatisfactory basis for the Tax Court's credibility determinations, and meaningful appellate review depends on knowing what was the basis for the credibility determination.

Additionally, this Court has recognized the importance of weighing the agreement (or lack thereof) between lower courts on factual findings. "That great weight is to be given to the findings of fact by the two lower courts is a rule of wisdom in the exercise of the reviewing power of this

[5] The concern that the Tax Court Judge will fail to give the proper deference and presumption of correctness to the STJ's credibility determinations and factual findings is heightened by the fact that STJs lack the guarantees of judicial independence enjoyed by Article III judges. *See Freytag*, 501 U.S. at 912 (Scalia, J., concurring in part and concurring in the judgment) (STJs "lack life tenure; their salaries may still be diminished; they are still removable by the President"). As explained below, *see infra* at 13, this observation does not equate to a determination that STJs are mere "aides" or "staff" of the Tax Court.

Court." *Offutt* v. *United States*, 348 U.S. 11, 15 (1954); *see also Easley* v. *Cromartie*, 532 U.S. 234, 242 (2001) ("Where an intermediate court reviews, and affirms, a trial court's factual findings, this Court will not 'lightly overturn' the concurrent findings of the two lower courts.") (quoting *Neil* v. *Biggers*, 409 U.S. 188, 193 n.3 (1972)); *Corn Prods. Refining Co.* v. *Commissioner*, 350 U.S. 46, 51 (1955) ("[O]n essentially factual questions the findings of two courts should not ordinarily be disturbed.").

This same principle applies in the administrative context. *See Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 496 (1951) ("[E]vidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion."); *NLRB* v. *Stor-Rite Metal Prods., Inc.*, 856 F.2d 957, 964 (7th Cir. 1988) (noting that when the NLRB "rejects the findings of the ALJ, a special problem of administrative review arises[,]" and the reviewing court may view the evidence supporting the Board's conclusion as "less substantial than it would be if the Board and the ALJ had reached the same conclusion") (internal citations and quotation marks omitted); *Simon* v. *Simmons Foods, Inc.*, 49 F.3d 386, 389-390 (8th Cir. 1995) ("While much deference is usually accorded to an agency's expertise and discretion when the agency adopts the findings of the ALJ, a slightly different rule applies when the administrative agency rejects the ALJ's findings. An agency departing from the findings of the ALJ must show that it gave attentive consideration to the ALJ's conclusions.") (internal citations omitted).

At bottom, the Tax Court's secreting of the STJ's report offends due process because it is important for an appellate court, in determining the degree of deference to be given to the Tax Court's factual findings, to know whether and why the Tax Court agreed with or rejected the STJ's findings of fact and credibility determinations. If the Tax Court agreed with the STJ's conclusions, appellate review for clear error is

properly deferential. But if the Tax Court rejected the factfinding and credibility determinations of the STJ who actually saw and heard the witnesses, further scrutiny is required on appeal. The Tax Court's refusal to disclose the STJ's report thus impedes the proper exercise of appellate review in violation of the Due Process Clause.

B. The STJ's Report Must Be Disclosed On Appeal Because It Has Legal Effect.

The denial of the STJ's Rule 183 report to an appellate court that is reviewing a decision of the Tax Court cannot be squared with the requirements of due process for the further reason that that report is a document having legal effect.

Rule 183 makes it mandatory for the STJ to produce a report: the STJ "*shall* submit a report, including findings of fact and opinion." Tax Ct. R. 183(b) (emphasis added). The rule then directs that the STJ's findings of fact "shall be presumed to be correct" and that deference—"[d]ue regard"—shall be given to the STJ's evaluation of the credibility of witnesses. Tax Ct. R. 183(c); *see also Freytag*, 501 U.S. at 874 n.3 ("deferential standard" applies to Tax Court review of STJ's factfinding). The Rule 183 report thus is a document that has a legally-operative effect upon the ultimate decision of the Tax Court.

That the Rule 183 report is a document with legal effect is underscored by the fact that STJs are not mere "aides" or "staff" of the Tax Court. Indeed, the powers and duties of STJs place them in an entirely different category from law clerks or other judicial assistants.

In *Freytag*, this Court held that STJs are "inferior Officers" of the United States (U.S. Const. art. II, § 2, cl. 2) who exercise significant governmental authority. *See Freytag*, 501 U.S. at 881. The *Freytag* Court rejected the Commissioner's contrary argument that an STJ "acts only as an aide to the Tax Court judge responsible for deciding the case" and that STJs should be deemed mere employees of the court

"because they lack authority to enter a final decision." *Id.* at 880, 881.

In rejecting that argument, the *Freytag* Court said that the Commissioner had "ignore[d] the significance of the duties and discretion that special trial judges possess." *Id.* The Court observed that "[t]he office of special trial judge is 'established by Law,' Art. II, § 2, cl. 2," and that an STJ's "duties and functions are * * * delineated in a statute." 501 U.S. at 881. The Court also noted that STJs "perform more than mere ministerial tasks. They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. In the course of carrying out these important functions, the special trial judges exercise significant discretion." *Id.* at 881-882.

In short, it cannot be consistent with due process for the Tax Court to withhold from a reviewing court of appeals a document that is legally required under Tax Court rules; prepared by a judicial officer vested with significant governmental authority; and having a legal effect upon the Tax Court's decision in the case.

C. *Mathews* v. *Eldridge* Requires Disclosure Of The STJ's Report To An Appellate Court.

As this Court recently confirmed, the test set forth in *Mathews* v. *Eldridge*, *supra*, is "[t]he ordinary mechanism * * * for determining the procedures that are necessary to ensure that a citizen is not 'deprived of life, liberty, or property, without due process of law.' " *Hamdi* v. *Rumsfeld*, 124 S. Ct. 2633, 2646 (2004) (plurality opinion of O'Connor, J.) (quoting the Fifth Amendment); *see also Burns* v. *United States*, 501 U.S. 129, 148 (1991) (Souter, J., dissenting) ("The *Mathews* analysis has thus been used as a general approach for determining the procedures required by due process whenever erroneous governmental action would infringe an individual's protected interest") (citing cases applying *Mathews* in a wide variety of circumstances). The *Mathews* test is properly applied here to determine the

requirements of due process in the tax adjudication context. *See McKesson Corp.*, 496 U.S. at 36 n.17.

Under *Mathews*, three factors are judicially analyzed and balanced to ascertain whether a challenged governmental procedure comports with due process:

> First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail. [424 U.S. at 335.]

Here, the application of the *Mathews* test leads to the conclusion that due process requires the disclosure of the STJ's report to a reviewing court of appeals.

The private interests at stake in Tax Court cases are undoubtedly significant. This Court has recognized that, like deprivations of liberty interests, the deprivation of a property interest can be severe. *See*, *e.g.*, *FDIC* v. *Mallen*, 486 U.S. 230, 243 (1988). In this case, Burton Kanter was found liable for civil tax fraud—a judgment that carries enormous pecuniary and other consequences. And that is not just a temporary deprivation; it is a permanent one. *Cf. City of Los Angeles* v. *David*, 538 U.S. 715, 717 (2003) (per curiam).[6]

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[6] The Tax Court's secretive process also has a broader impact upon the Nation's small businesses and economic growth. Small businesses are crucial to the American economy and job creation. There are some 22.4 million small businesses in the United States, representing 99 percent of all employers and creating two-thirds to three-quarters of net new jobs. *See* House of Representatives, Small Business Comm., Small Business Facts, *available at* http://wwwc.house.gov/smbiz/smallBusinessFacts/smallBusinessFacts.asp. When a small business is subjected to erroneous taxation—*i.e.*, the imposition of taxes that the business is not, in fact, obligated to pay—it undermines the viability of the small business. Yet the Tax Court's secretive handling of STJ reports can only

The governmental interest in withholding the STJ's report from a reviewing court of appeals, conversely, is not readily apparent. Tax Court Rule 183 already requires STJs to prepare reports and file them with the Tax Court. The burden of including that document in the record on appeal is negligible. And it is hard to see what legitimate governmental interest could be served by denying the parties and the appellate court access to a document that has independent legal significance.

The remaining *Mathews* factor—the risk of an erroneous deprivation due to the Tax Court's refusal to release the STJ's report—points strongly in favor of releasing such reports on appeal. Appellate review of initial adjudications affecting significant private interests is a defining characteristic of the American legal system because such review is essential to reaching fair and accurate judgments. Accordingly, this Court has recognized the importance of appellate review to obtaining correct adjudications, in both civil and criminal contexts. *See Cooper Indus., Inc.* v. *Leatherman Tool Group, Inc.*, 532 U.S. 424, 436 n.9 (2001); *Griffin* v. *Illinois*, 351 U.S. 12, 18 (1956) (plurality opinion). And, as shown above, nondisclosure of the STJ's report impairs a court of appeals' ability to review the Tax Court's factfinding. By lifting the veil off these reports, this Court can only improve the accuracy of appellate decision making. *See Joint Anti-Fascist Refugee Comm.* v. *McGrath*, 341 U.S. 123, 171 (1951) (Frankfurter, J., concurring) ("Secrecy is not congenial to truth seeking").

The risk of erroneous deprivation is exemplified in this case by the fact that both of the courts below assumed that the STJ "opinion" adopted by the Tax Court was in fact the STJ's Rule 183 report without any evidence to support this assumption. *See Ballard*, 321 F.3d at 1040 ("Judge Dawson issued the opinion of the Tax Court in which the Tax Court both approved of and adopted Special Trial Judge Couvil-

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discourage small businesses from resorting to the Tax Court to contest erroneous taxation.

lion's *report*.") (emphasis added); *Estate of Kanter*, 337 F.3d at 840-841. An appellate court cannot conduct a meaningful review if it is not sure whether the STJ's report and opinion are one and the same.

D. The Tax Court Stands Alone In Its Secret Process.

Transparency is one of the hallmarks of a fair judicial process. As Justice Frankfurter stated in *McGrath*, 341 U.S. at 170, "fairness can rarely be obtained by secret, one-sided determination of facts decisive of rights." *Accord Connecticut* v. *Doehr*, 501 U.S. 1, 14 (1991). A transparent process is also necessary to ensure public confidence in the integrity of the judicial system. Thus, this Court has stressed that "[o]penness * * * enhances * * * the appearance of fairness so essential to public confidence in the system." *Press-Enterprise Co.* v. *Superior Court of Cal., Riverside County*, 464 U.S. 501, 508 (1984); *see also Richmond Newspapers, Inc.* v. *Virginia*, 448 U.S. 555, 572 (1980) ("People in an open society do not demand infallibility from their institutions, but it is difficult for them to accept what they are prohibited from observing.").

The secrecy with which the Tax Court treats the STJ reports undermines the confidence of both the public and the appellate courts that the Tax Court complied with its own rule requiring it to "presume[ ] to be correct" the STJ's findings of fact and to give "[d]ue regard" to the STJ's credibility determinations. Tax Ct. R. 183(c). Disclosure of the STJ report would lend transparency to the Tax Court's process and facilitate appellate review of that court's judgments. As it is, the Tax Court's current secretive procedures cast a shadow over the integrity of its factfinding. The lack of transparency in the Tax Court proceedings invariably and unnecessarily gives rise to speculation about how and why a case was decided as it was.

Not surprisingly, the Tax Court stands alone in refusing to ensure proper appellate review by secreting the reports of initial factfinders. The STJ "acts in a capacity not dissimilar to that of a magistrate in district court." *Estate of Smith* v.

Commissioner, 638 F.2d 665, 669 (3d Cir. 1981). But the reports of magistrate judges, and other similar judicial officers, including bankruptcy judges, special masters, and administrative law judges, must be part of the record on review. *See* 28 U.S.C. § 636(b)(1)(C) ("the magistrate judge shall file his proposed findings and recommendations * * * with the court and a copy shall forthwith be mailed to the parties"); Fed. R. Bankr. P. 9033(a) ("the bankruptcy judge shall file proposed findings of fact and conclusions of law"); Fed. R. Civ. P. 53(e) ("master who makes an order must file the order and promptly serve a copy on each party"); Fed. R. Civ. P. 53(f) (requiring special master to file report and promptly serve on the parties "unless the court directs otherwise"); 5 U.S.C. § 557(c) ("All [preliminary agency] decisions, including initial, recommended, and tentative decisions, are a part of the record * * *."). This Court also provides parties access to the reports of its special masters, to which the parties may make exceptions. *See, e.g., Kansas* v. *Colorado*, 533 U.S. 1, 5-6 (2001); *Colorado* v. *New Mexico*, 467 U.S. 310, 313 (1984).

As the courts of appeals have repeatedly recognized, transparency serves a critical role in the appellate review process. For instance, if the appellate court does not have access to the factual findings of the magistrate judge, it cannot ensure that the district court appropriately performed its review nor can it correctly perform its own clear-error review. *See, e.g., Cooper-Houston* v. *Southern Ry.*, 37 F.3d 603, 604 (11th Cir. 1994) (overruling summary judgment on the ground that the district court was "bound to defer to the factual determinations of the magistrate judge unless those findings were clearly erroneous"); *Shabazz* v. *Askins*, 980 F.2d 1333, 1334-35 (10th Cir. 1992) (finding that the district court abused its discretion in adopting a magistrate's report that incorrectly weighed disputed facts); *Phinney* v. *Wentworth Douglas Hosp.*, 199 F.3d 1, 4 (1st Cir. 1999) (determining that the magistrate's account of the facts was not clearly erroneous and therefore affirming the district court's judgment).

The same need for access to the initial factfinder's report holds true in the review of decisions of bankruptcy judges and administrative law judges. *See, e.g., In re Webb*, 954 F.2d 1102, 1108 (5th Cir. 1992) ("The district court did not properly apply the clearly erroneous standard of review to the findings of the bankruptcy court. Had it done so, it would have concluded, as [d]o we, that the bankruptcy court's findings were plausible, and, therefore, were not clearly erroneous."); *Ewing* v. *NLRB*, 732 F.2d 1117, 1118 (2d Cir. 1984) (overruling decision of NLRB to reverse ALJ's credibility determinations because "[i]t is the task of trial judges to separate factual wheat from evidentiary chaff, and appellate courts must accord great deference to these determinations[,] [and] [t]he same policies apply in the administrative context when decisions of the finder of fact are brought under review").

A constitutionally proper appeal requires an appellate court to be able to review the findings of the STJ—the judicial officer who presided over the trial, observed the witnesses, and made the critical credibility determinations. The Tax Court's refusal to provide a complete record for appellate review and insistence on judicial secrecy violates due process. This Court should condemn that practice—a practice that does not comport with the fair and open process that litigants and the public expect of our judicial institutions.

II. INTERPRETING 26 U.S.C. §§ 7459 AND 7461 TO REQUIRE DISCLOSURE OF THE STJ'S REPORT AVOIDS THE DUE PROCESS ISSUE.

Under this Court's doctrine of constitutional doubt, "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Edward J. DeBartolo Corp.* v. *Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988); *see also Ashwander* v. *TVA*, 297 U.S. 288, 348 (1936) (Brandeis, J., concurring); *United States ex rel. Attorney General* v. *Delaware & Hudson Co.*, 213 U.S. 366, 408 (1909) ("[W]here a statute is

susceptible of two constructions, by one of which grave and doubtful constitutional questions arise and by the other of which such questions are avoided, our duty is to adopt the latter.").

As shown above, the Tax Court's failure to disclose STJ reports raises a serious due process question. That question can be avoided, however, by interpreting two provisions of the Internal Revenue Code—26 U.S.C. §§ 7459(b) and 7461(a)—to require disclosure of such reports. Section 7461(a) provides that "all reports of the Tax Court * * * shall be public records open to the inspection of the public." And Section 7459(b) states that "[t]he Tax Court shall report in writing all its findings of fact, opinions, and memorandum opinions." These statutes can and should be construed to require disclosure of the STJ's report and thereby avoid the substantial due process issue that would otherwise arise. *Cf. Burns*, 501 U.S. at 138 (avoiding due process problem by construing Fed. R. Crim. P. 32 to prohibit district court from departing upward from Sentencing Guidelines range without providing notice of its intent to do so).

The plain language of both Section 7461(a) and 7459(b) would seem to encompass the STJ reports required by Rule 183 and the contents of those reports. Section 7461(a) makes publicly available all "reports" of the Tax Court. A Rule 183 report clearly is a "report"; indeed, that is the very term used in Rule 183. Section 7459(b), meanwhile, applies to all "findings of fact" and "opinions," and the STJ's report is expressly required to "includ[e] findings of fact and opinion." Tax Ct. R. 183(b). Thus, STJ reports appear to fall squarely within the coverage of these statutes. At the very least, it cannot be said that it would be "plainly contrary to the intent of Congress," *Edward J. DeBartolo Corp.*, 485 U.S. at 575, to construe these statutes so as to avoid the due process problem entailed by withholding STJ reports from a reviewing court of appeals.

CONCLUSION

For the foregoing reasons, the judgments below should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

CLAUDE M. BALLARD, ET UX.,
ESTATE OF BURTON W. KANTER, ET AL.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURTS OF APPEALS FOR THE SEVENTH AND ELEVENTH CIRCUITS

BRIEF OF *AMICI CURIAE* SENATOR DAVID PRYOR; THE ESTATE OF ROBERT W. LISLE; AND THE ESTATE OF DONNA M. LISLE IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether the Due Process clause of the Fifth Amendment obliges the Tax Court to disclose the findings of the Special Trial Judge, when the Tax Court's rules oblige the trial judge to make such findings and require the Tax Court to presume that these findings are correct.

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A. Because the STJ's report is entitled to a presumption of being correct under Rule 183(c), this report is critically important for assessing the sufficiency of the evidence supporting the Tax Court's opinion. 6

B. The Tax Court must disclose the STJ's report as part of its general duty to disclose findings that critically affect the sufficiency of the evidence underlying the Tax Court's decision. 9

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INTERESTS OF *AMICI CURIAE*[1]

Hon. David Pryor served as United States Senator from Arkansas from 1979 to 1996 and as a United States Representative from 1966 to 1973. While in the Senate, Senator Pryor served on the Senate Finance Committee, chairing a subcommittee with responsibility for oversight of the Internal Revenue Service. While in this position, he developed and introduced the first Taxpayer Bill of Rights which was enacted in 1988. *See* Omnibus Taxpayer Bill of Rights, Pub. L. No. 100-647, §§6226-35, 102 Stat. 3342, 3731. As a Member of the House of Representatives, Senator Pryor supported and voted for the Tax Reform Act of 1969, §951, Pub. L. No. 91-172, 83 Stat. 730, which, in order to ensure neutrality and procedural regularity, removed the Tax Court (previously the Board of Tax Appeals) from the Executive Branch and transformed it into an Article I Court. *See* 115 Cong. Rec. H22809, 91st Cong. 2d Sess. (Aug 7, 1969) (roll call vote).

Senator Pryor's actions have been motivated by an abiding belief that taxpayers in the United States have basic rights, including the right to due process of law, a right that is infringed by the proceedings to which the taxpayers here have been subjected. In speaking on the floor of the Senate in support of his landmark 1988 legislation he said "The passage of the taxpayers' bill of rights will send, I think, a very clear message to our country and to all taxpayers, small and large, that taxpayers do in fact have certain basic due process rights ...." 134 Cong. Rec. S15073, S15074, 100th

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[1] In compliance with Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part. No person other than *amici* or their counsel made a monetary contribution to the preparation or submission of this brief. Pursuant to Supreme Court Rule 37.3, copies of letters of consent to the filing of this brief have been lodged with the Court.

Cong. 2d Sess. (Oct. 7, 1988) (statement of Sen. Pryor). "Like any good citizen," he said, "I believe that everyone should pay his or her lawful share of taxes. That is the price of freedom. However, at the same time that we are allowing the IRS to be more intrusive into the lives of our citizens for the sake of compliance, we must also ensure that we maintain basic due process rights, which have eroded slowly but surely over these past two and one-half decades." 134 Cong. Rec. S4134, 100th Cong. 2d Sess. (April 15, 1988) (statement of Sen. Pryor). Senator Pryor seeks to put his views before this Court because of his conclusion that, despite his legislative efforts, the secret procedures now used by the Tax Court and at issue here deprive taxpayers of those basic rights.

Taxpayers Robert and Donna Lisle ("the Lisles") were parties in the Tax Court proceeding under review here. As provided for by 26 U.S.C. §7482(b)(1)(A), because of their legal residence the Lisles' appeal from the adverse decision of the Tax Court was heard by a different Court of Appeals, the United States Court of Appeals for the Fifth Circuit, in a different case than that under review by this Court. *See Estate of Lisle v. Commissioner*, 341 F.3d 364 (5th Cir. 2003). In that case, even despite the unavailability of the Special Trial Judges' report in this case, the Court of Appeals concluded that the credibility and other judgments of the Tax Court were insufficiently supported by the evidence to sustain the finding of fraud against Robert Lisle that formed the basis for most of the tax deficiency and penalties assessed against the Lisles. The Lisles died during the pendency of their appeal. Their estates appear before this Court as *amici curiae* because of the denial of due process that it is now clear was wrought by the routine practice of the Tax Court utilized in the proceeding in which the remaining deficiency against the Lisles — the amount of which remains to be determined on remand in their case — was assessed.

INTRODUCTION AND SUMMARY OF ARGUMENT

The issue in this case hinges on a principle of procedural transparency so basic that, outside of the Tax Court, it is universally observed by both courts and administrative agencies. This principle is that, if an agency or tribunal relies on a trial judge to hear testimony and, based on that hearing, to make factual findings that enjoy a presumption of being correct, then that agency or tribunal must disclose that judge's recommended findings to the parties whose rights are affected by them. The Tax Court has given special importance to the factual recommendations of the Special Trial Judge ("STJ") by providing in Tax Court Rule 183(c) that "the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Given that the Tax Court has invested the STJ's factual recommendations with a presumption of validity, the Tax Court must disclose those factual recommendations to the parties, because such presumptively valid findings help determine whether there is sufficient evidence underlying the Tax Court's decisions. Thus, the STJ's report has at least the same importance as a potentially decisive piece of evidence. Just as the Tax Court is obliged to disclose evidence on which its decisions rest, so too, the Tax Court is obliged to disclose recommended fact findings that it must presume to be correct.

Because the Tax Court has chosen to invest the factual recommendations contained in the STJ's report with a presumption of validity, those recommended findings cannot be regarded as the purely internal deliberations of the Tax Court. Internal deliberations (*e.g.*, law clerks' memos, staff attorney's recommendations, judge's draft opinions) need not be disclosed, because such deliberations are not legally relevant to the parties' proof or rights and do not limit the tribunal's discretion. The tribunal is, by contrast, not free to ignore completely the STJ's report, because the Tax

Court's own Rule 183(c) requires that this report be accorded a presumption of being correct. By conferring this legal force on the report, the Tax Court has taken it outside the realm of purely internal advice and transformed it into a potentially decisive aspect of the proof.

Disclosure of the STJ's report, therefore, is critically important if the parties are to know whether and to what extent the legal presumptions created by the STJ's report favors or undermines their case. Against this private interest in disclosure, the Tax Court has no legitimate interest in withholding this document from the parties. The Tax Court's Rule 183(b) already requires the STJ to submit such a report to the Tax Court. Therefore, disclosure imposes no additional paperwork or other fiscal or administrative burden on any governmental agency.

The only burden created by disclosure is the burden of transparency. By revealing the presumptively correct statement of facts to the parties and appellate courts, disclosure makes it possible for both to enforce the Tax Court's own rules. But no agency has a legitimate interest in evading appellate review. The Tax Court undoubtedly has broad discretion to structure the mechanisms by which the parties' testimony can be considered. The Tax Court has exercised this discretion by creating a system of hearings before STJs, in which the STJ's findings are presumed correct and "[d]ue regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses." Having chosen such a system for protecting the parties' right to present in-person testimony, the Tax Court cannot then undermine its own rules through a policy of bureaucratic secrecy.

ARGUMENT

THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT OBLIGES THE TAX COURT TO DISCLOSE THE SPECIAL TAX JUDGE'S REPORT TO THE PETITIONERS, BECAUSE THESE FINDINGS, BEING PRESUMPTIVELY CORRECT AS A MATTER OF THE TAX COURT'S OWN RULES, CRITICALLY AFFECT THE SUFFICIENCY OF THE PARTIES' EVIDENCE AND BECAUSE THE TAX COURT FACES NO ADMINISTRATIVE BURDEN IN PROVIDING THE REPORT TO PETITIONERS.

This Court determines the specific requirements of procedural due process by weighing "the private interest that will be affected by the official action" against "the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976). No hard and fast rule defines what sorts of procedures are constitutionally required. Instead, this Court performs a context-specific inquiry to determine whether the probable value of additional procedures in preventing an erroneous deprivation of some private interest outweighs the administrative burdens entailed by the procedure. *Id.* In making this *ad hoc* assessment, the Court takes guidance from customary administrative and judicial practices. *Honda Motor Co., Ltd. v. Oberg*, 512 U.S. 415, 430 (1995) (citing decisions for the proposition that "traditional practice provides a touchstone for constitutional analysis" in due process cases). Procedures long in use by a wide array of governmental decision-makers have so withstood the test of time that they cannot be regarded as unduly burdensome. *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 277 (1856) (in defining what due process requires, "we must look to those settled usages and modes of proceeding existing in the

common and statute law of England, before the emigration of our ancestors, *and which are shown not to have been unsuited to their civil and political condition by having been acted on by them* after the settlement of this country") (emphasis added)

Judged by this standard, there can be little doubt that the Fifth Amendment's due process clause requires disclosure of the adjudicative fact-findings of trial judges, administrative law judges, and other initial factfinders *whenever the law invests those findings with the presumption of being correct.* Such disclosure is certainly sanctified by tradition: it has always been virtually the universal practice even in administrative tribunals as well as Article I courts.[2] Two reasons justify a virtually universal practice of disclosure. First, when such fact-findings are invested by the law with a presumption of being correct, then they play a decisive role in determining whether the evidence before the final decision-maker is legally sufficient. Due process forbids keeping a party in the dark about such an essential aspect of the evidence. Second, where statute or regulation already requires an officer to provide written findings, the agency or court that relies on such findings faces no administrative burden whatsoever in disclosing them to the parties governed by them. In short, the cost to the government of disclosure is nil, while the effect of non-disclosure on the parties' capacity to present their proof is extraordinary. Thus, as explained in more detail below, common sense bolsters tradition in requiring disclosure of such findings.

[2] Under section 557 of the Administrative Procedure Act, the reports of hearings officers automatically become part of the administrative record. 5 U.S.C. §557(c). Federal law also requires Article I judges such as federal magistrates and bankruptcy judges to disclose their findings to the parties. 28 U.S.C. §636(b)(1)(C) ("The magistrate judge shall file his proposed findings and recommendations under subparagraph (B) with the court and a copy shall forthwith be mailed to all parties"); Bankr. R. 9033(a) (In non-core proceedings, "[t]he clerk shall serve forthwith copies [of bankruptcy judge's findings of fact] on all parties by mail and note the date of mailing on the docket"); Bankr. R. 9022 (notice and service of bankruptcy judges' orders and judgments). To counsel's knowledge, the Tax Court's policy of withholding the reports of special trial judges is unique among federal and state agencies and courts. As Judge Cudahy noted in his dissenting opinion, "[e]ven the Commissioner, at oral argument, acknowledged that in every milieu except that of the Tax Court, the document containing the findings or recommendations of the official conducting the trial are available to a court reviewing the operative decision." *Estate of Kanter v. Comm'r*, 337 F.3d 833, 874 (7th Cir. 2003).

The Commissioner maintains that the procedures used by the Tax Court do not violate traditional procedural protections, because tax disputes are not governed by the customs governing common-law courts and because "Tax Court judges need not operate in a manner precisely identical to Article III courts." Brief in Opposition to Certiorari at 17. These statements, however, attack straw men: neither *amici* nor Petitioners argue that the Tax Court is governed by the common law or by Article III. The question is whether the Tax Court complies with the procedural traditions of *any* tribunal, administrative or judicial, Article I or Article III. The answer is obvious: as Judge Cudahy noted, the Tax Court's refusal to disclose the factual recommendations of the STJ is simply unprecedented among any sort of tribunal and wholly at odds even with ordinary administrative practices. *Estate of Kanter*, 337 F.3d at 879 (Cudahy, J., dissenting).

I. WHEN AN OFFICER'S FINDINGS ARE PRESUMED TO BE CORRECT AS A MATTER OF LAW, THEN THEY MUST BE DISCLOSED TO PARTIES, BECAUSE THEY PLAY A DECISIVE ROLE IN DEFINING THE SUFFICIENCY OF THE PARTIES' EVIDENCE.

That disclosure of the STJ's report has enormous practical importance as a procedural safeguard rests on two well-settled principles. First, the STJ's report has at least the same weight as a potentially decisive piece of evidence, because the Tax Court's regulations invest this report with a presumption of being a correct statement of the facts. Tax Ct. R. 183(c). Second, the Tax Court has a duty to disclose to the Petitioners

all documents that have such critical bearing on whether there is sufficient evidence underlying the Tax Court's opinion. The inescapable corollary of these two propositions is that the Tax Court must disclose the contents of the STJ's report, because this report determines the sufficiency of the evidence in this case.

A. Because the STJ's report is entitled to a presumption of being correct under Rule 183(c), this report is critically important for assessing the sufficiency of the evidence supporting the Tax Court's opinion.

When statute or rule commands that a judge's initial fact-findings are presumptively correct, then those findings critically affect the sufficiency of the evidence underlying the final decision-maker's conclusion. This is true even when such findings are recommendations that the final decision-maker is entitled to overturn. As this Court has stated in *Universal Camera*, "evidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion." *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 496 (1951). For this reason, the recommended findings of the trial judge are essential for a complete evaluation of the sufficiency of the evidence before a tribunal like the Tax Court, and such a tribunal must carefully consider such findings even if it ultimately decides to reject them. In *Universal Camera*'s categorical command, "[t]he findings of the examiner *are to*

be considered along with the consistency and inherent probability of testimony." *Id.* (emphasis added).[3]

The judge's initial factual recommendations are especially important when the judge is the only officer who has heard the witnesses' testimony first-hand. In cases where the credibility of the witnesses bears on the decision, the judge's recommended findings provide the ultimate decision-maker with the only mechanism through which to consider such credibility. *United States v. Raddatz*, 447 U.S. 667, 681 n.7 (1980) ("we assume it is unlikely that a district judge would *reject* a magistrate's proposed findings on credibility when those findings are dispositive and substitute the judge's own appraisal; to do so without seeing and hearing the witness or witnesses whose credibility is in question could well give rise to serious questions which we do not reach"); *Goldberg v. Kelly*, 397 U.S. 254, 269 (1970) ("Particularly where credibility and

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[3] Although *Universal Camera* addresses the standard for evaluating whether substantial evidence exists in the record to support an administrative agency's decision, its reasoning applies with equal force to review of the Tax Court's decisions for clear error. As this Court has noted, there are only subtle distinctions between the "clear error" standard and the "substantial evidence" standard. *Dickinson v. Zurko*, 527 U.S. 150, 162-163 (1999). Moreover, *Universal Camera* was rooted in the requirement contained in the Taft-Hartley Act, 61 Stat. 148, 29 U.S.C. §160(e) that the substantiality of the evidence be assessed in light of the "record considered as a whole." *Universal Camera*, 340 U.S. at 493. Likewise, in reviewing a court's fact-finding for "clear error," the reviewing court must consider the "entire evidence" and not merely those portions of the record that favor the trial court's factual conclusions. *Anderson v. City of Bessemer City*, 470 U.S. 564, 573 (1985) (quoting *United States v. United States Gypsum Co.*, 333 U.S. 364, 395 (1948)) ("'[a] finding is 'clearly erroneous' when *although there is evidence to support it*, the reviewing court on the *entire evidence* is left with the definite and firm conviction that a mistake has been committed'") (emphasis added). It follows that consideration of the STJ's report is just as essential for determining "clear error" in light of the "entire evidence" as consideration of a hearing officer's findings is for assessing whether "substantial evidence" in the "whole record" underlies an agency's decision.

ity and veracity are at issue ... written submissions are a wholly unsatisfactory basis for decision"). Thus, where credibility is at stake, the reports of the judge who observed such testimony will constitute an especially important part of the record, and *Universal Camera*'s principle that the administrative decision-maker must consider such reports applies with special force. Applying this principle to agency decisions, lower courts are unanimous in holding that the hearing officer's determinations of witnesses' credibility are part of the evidence that must be considered in order to determine whether an agency's decision is supported by substantial evidence.[4] It follows with at

[4] *Chen v. GAO*, 821 F.2d 732, 734 (D.C. Cir. 1987) ("the evidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion" and agency reversals of the examiner "are normally scrutinized very carefully to ensure there is some reasoned explanation of the board's disagreement with the decision of the hearing officer"); *Parker v. Bowen*, 788 F.2d 1512, 1520 (11th Cir. 1986) ("We hold that the Appeals Council is not bound by the ALJ's credibility findings, but when it rejects such findings, it should ordinarily do so expressly, articulating the reasons for its conclusion"); *SKS Die Casting & Machining v. NLRB*, 941 F.2d 984, 988-89 (9th Cir. 1991)("The ALJ's contrary findings are one factor that we consider in evaluating whether the Board's findings are supported by substantial evidence"); *Citizens St. Bank v. Federal Deposit Ins. Corp.*, 718 F.2d 1440, 1445 (8th Cir.1983) ("The Board's departure from the ALJ's findings is vulnerable if it fails to reflect attentive consideration to the ALJ's decision"); *Chicago Tribune v. NLRB*, 974 F.2d 973, 935 (7th Cir. 1992) ("an administrative law judge's determinations of credibility are entitled to a certain weight by a reviewing court, because he sees and hears the witnesses and the Board has only a transcript of their testimony"); *Brock v. L.E. Myers Co., High Voltage Div.*, 818 F.2d 1270 (6th Cir. 1987) (requiring Occupational Safety and Health Review Commission to articulate reasons for failing to credit findings of an ALJ who had a unique opportunity to observe demeanor of witnesses); *Centre Property Management v. NLRB*, 807 F.2d 1264 (5th Cir. 1987) (applying "more searching" scrutiny to board's findings where they conflict with ALJs); *Blackburn v. Martin*, 982 F.2d 125, 128 (4th

least equal force that, when reviewing the entire evidence to determine whether the Tax Court committed "clear error" in its findings of fact, the STJ's assessment of credibility must be considered.

B. The Tax Court must disclose the STJ's report as part of its general duty to disclose findings that critically affect the sufficiency of the evidence underlying the Tax Court's decision.

Given the authority that Rule 183(c) confers on the STJ's report, this report must be disclosed to the Petitioners, because this report critically affects whether sufficient evidence underlies the Tax Court's opinion. The Tax Court is obliged by its own rules to take the STJ's report into consideration, because, according to Rule 183(c), this report must be presumed to be correct. It is a "relatively immutable [principle] in our jurisprudence" that "the evidence used to prove the Government's case must be disclosed to the individual so that he has an opportunity to show that it is untrue." *Greene v. McElroy*, 360 U.S. 474, 496-497

Cir. 1992) ("In conducting our review, we consider the entire record before us, including the ALJ's recommendation and any evidence that is contrary to the Secretary's determination"); *Eastern Engineering & Elevator Co v. NLRB*, 637 F.2d 191, 197 (3rd Cir. 1980) (NLRB's factual findings are overturned where NLRB "failed to accord due weight to the ALJ's findings of fact," because NLRB "was required to extend some, but not absolute, deference to the ALJ's determinations" on credibility of witnesses); *NLRB v. Cooper Union for Advancement of Science and Art*, 783 F.2d 29, 31 n.2 (2d Cir. 1986) ("We recognize that when the Board makes findings inconsistent with the ALJ, as here, the findings are more open to question than if the Board and the ALJ had reached the same result, but only if the evidence turns on the credibility of the witnesses"); *C.E.K. Indus. Mechanical Contractors, Inc. v. NLRB*, 921 F.2d 350, 355 (1st Cir. 1990) ("In cases such as this one, however, where the Board has reached a conclusion opposite of that of the ALJ, our review is slightly less deferential than it would be otherwise").

(1959). *See also Carter v. Kubler*, 320 U.S. 243, 247 (1943) ("The basic elements of such a [fair and full] hearing include the right of each party to be apprised of all the evidence upon which a factual adjudication rests, plus the right to examine, explain or rebut all such evidence"). It follows *a fortiori* that the STJ's report must also be disclosed, given the legal force with which the Tax Court has invested the STJ's report through Rule 183(c), because the findings of the STJ's report will affect the sufficiency of the evidence supporting the Tax Court's opinion. If the STJ's report is inconsistent with the Tax Court's view of the facts, then this inconsistency will weaken the evidentiary underpinning of the Tax Court's opinion and, where the evidence is otherwise close, suggest that the Tax Court committed clear error. Thus, the Tax Court can no more conceal the STJ's report from the Petitioners than it can conceal evidence that would affect judicial assessment of the evidentiary basis for the Tax Court's decision.

The importance of the STJ's report is especially great in this case because of the centrality of credibility evaluations to the Tax Court's finding of fraud. The Tax Court found that there was clear and convincing evidence that Burton Kanter was motivated by fraudulent intent in his alleged underpayment of taxes. Without disclosing what the STJ's report found concerning Kanter's testimony, the Tax Court's opinion relied, in part, on "the lack of credibility of Kanter's testimony." *Estate of Kanter v. Comm'r of Internal Revenue*, 337 F.3d 833, 846 (7th Cir. 2003). But this finding would be critically weakened if the STJ's report found that Kanter's testimony on his intentions was credible. Likewise, the Tax Court found that Ballard had committed tax fraud in part based on "Ballard's false and misleading testimony to the Tax Court." *Ballard v. Comm'r*, 321 F.3d 1037, 1043 (11th Cir. 2003). However, Ballard did not present testimony to "the Tax Court" but rather to the STJ. If the

STJ's report, presumed correct under Rule 183(c), had found that Ballard's testimony was neither false nor misleading, then this finding would severely undermine the evidentiary basis for the Tax Court's finding." In the words of *Universal Camera*, the evidence of fraud would become "less substantial" because "an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the [Tax Court's]." *Universal Camera*, 340 U.S. at 496. That the finding of fraudulent intent hinged on the undisclosed contents of that report is indicated by both the Seventh Circuit's and the Eleventh Circuit's opinions below, both of which upheld the Tax Court's finding of clear and convincing evidence of fraudulent intent in reliance on the Tax Court's assurance that the Tax Court's finding was consistent with the STJ's report. *Estate of Kanter*, 337 F.3d at 847. *Ballard v. Comm'r*, 321 F.3d at 1042 (relying on "critical fact" that the record as presented to us clearly reveals that the report adopted by the Tax Court is Special Trial Judge Couvillion's report").

Therefore, it was essential for Petitioners to know exactly what the STJ's report found concerning Kanter's and Ballard's intent in order to focus effectively their argument before the Tax Court and the Seventh and Eleventh Circuits. Under the Tax Court's rules, the Petitioners were permitted to file a post-trial motion for reconsideration of findings. Tax Ct. R. 161. But absent disclosure of the STJ's report, it was impossible for the Petitioners to discover and invoke any inconsistency between the STJ's report and the Tax Court's opinion as a basis for such a motion. In effect, by concealing the contents of the STJ's report, the Tax Court concealed from the Petitioners potentially decisive evidence that the Tax Court was legally obliged to consider as part of its decision-making process.

This Court has held that it is "illogical" for an administrative agency to deny a party the opportunity to

show that the expert opinions on which the agency relies are contradicted by other evidence. *Reilly v. Pinkus*, 338 U.S. 269, 275-76 (1949) ("It certainly is illogical, if not actually unfair, to permit witnesses to give expert opinions based on book knowledge, and then deprive the party challenging such evidence of all opportunity to interrogate them about divergent opinions expressed in other reputable books"). It is even more irrational for an Article I court to bar a party from having an opportunity to contradict the Tax Court's findings with the STJ's report. Unlike the medical dictionaries excluded from the evidence in *Reilly*, the STJ's report is not merely just one more piece of evidence. Rather, it is the legally authoritative statement of findings by the only judge to hear the testimony in this case, findings that the Tax Court was obliged by its own rules to presume correct and, at the very least, to consider carefully before rejecting them. Excluding such a report from the record even though the Tax Court was legally obliged to consider the report is tantamount to barring potentially decisive evidence from the record even though the court actually considered such evidence in reaching its decision.

In response to these concerns, the Tax Court assures the Petitioners and this Court that its own opinion gave appropriate regard to the STJ's report.[5] But this assertion confuses substance with procedure. The issue before this Court is not the substantive one of whether the Tax Court's opinion was supported by sufficient evidence and, therefore, should be affirmed on the merits. Rather the issue is the procedural

[5] As proof of this assertion, the Tax Court notes that the STJ signed a declaration endorsing the Tax Court's opinion. Such a declaration, of course, shows only that the STJ endorsed the Tax Court's opinion, not that the STJ's report provided support for that opinion. Rule 183(c) invests only the latter with a presumption of being correct. That the STJ might have changed his mind after consulting with the Tax Court judges is, from an evidentiary point of view, irrelevant.

question of whether the Petitioners and the reviewing court of appeals received a fair opportunity to make an independent evaluation of the sufficiency of the evidence underlying the Tax Court's opinion. The Due Process clause requires that the Petitioners be given "the evidence used to prove the Government's case" so that the Petitioners "have an opportunity to show that it is untrue." *Greene v. McElroy*, 360 U.S. 474, 496-497 (1959). It is, of course, possible that the STJ's report supports the Tax Court's opinion in every respect. (If so, it is curious that the Tax Court refuses to release this report to Petitioners and the appellate courts). Regardless, this is a possibility that the Petitioners, the Seventh Circuit, the Eleventh Circuit, and, indeed, this Court are incapable of evaluating until the STJ's report is disclosed. *See Hoffman-LaRoche v. Kleindienst*, 464 F.2d 1068, 1072 (3rd Cir. 1972) (Requiring disclosure of advisory committee's report on which FDA's decision was based and noting that "[w]e cannot tell whether the failure to produce the Advisory Committee's report and its supporting documents was or was not prejudicial to Hoffmann until we examine them").

The Tax Court can no more support its decision by asserting that it had properly deferred to the undisclosed STJ's report than it could support its decision by referring to undisclosed testimony that allegedly supported the decision. *See Ohio Bell Tel. Co. v. PUC*, 301 U.S. 292, 303-04 (1937)(Deprivation of due process where Commission altered valuation of property relying on the "the strength of information secretly collected and never yet disclosed," because appellate court could not "intelligently decide that the findings of the Commission were supported by the evidence when the evidence that it approved was unknown and unknowable"). The Petitioners, like any other private party, is entitled to see the evidence for themselves and not rely on the Tax Court's *ipse dixit* that the STJ's report somehow supports — or does not under-

mine — the Tax Court's conclusions. As Justice Holmes observed ninety-one years ago, "[a]ll parties must be fully apprised of the evidence submitted or to be considered, and must be given opportunity to cross-examine witnesses, to inspect documents, and to offer evidence in explanation or rebuttal. ... for otherwise, even though it appeared that the order was without evidence, the manifest deficiency could always be explained on the theory that the Commission had before it extraneous, unknown, but presumptively sufficient information to support the finding." *ICC v. Louisville & Nashville Ry Co.*, 227 U.S. 88, 93 (1913).

The Tax Court's duty to disclose critical pieces of evidence and documents affecting the weight of such evidence is illustrated by this Court's decision in *Gonzales v. United States*, 348 U.S. 407 (1955). *Gonzales* held that a person seeking an exemption from military conscription as a conscientious objector was entitled to a copy of the Department of Justice's report to the Draft Appeals Board recommending that the exemption be denied. In rejecting the view that the Appeals Board could withhold the report, the Court noted that "our underlying concepts of procedural regularity and basic fair play" required that "a copy of the recommendation of the Department be furnished the registrant at the time it is forwarded to the Appeal Board, and that he be afforded an opportunity to reply." *Gonzales*, 348 U.S. at 412. The Court rejected the notion that the Appeals Board could withhold the report because it was "advisory," observing that precisely because the Appeals Board was "the only decision-making body to pass on the entire file," Gonzales needed to have the opportunity to reply to the Department of Justice's report in order to "insur[e] that this Board will have all of the relevant data." According to the *Gonzales* Court, "if the registrant is to present his case effectively to the Appeal Board, he must be cognizant of all the facts before the

Board as well as the over-all position of the Department of Justice." *Gonzales*, 348 U.S. at 413.

As with *Gonzales*, the relevant federal decisionmaker in this case has been supplied with a report summarizing the results of an investigation and making factual recommendations. Just as Gonzales could not effectively present his case before the Appeals Board without knowing about the contents of the Department of Justice's report, so too, the Petitioners could not effectively present their case to the Tax Court without knowing the factual recommendations of the STJ. The trial before the STJ produced a voluminous record with over 5,000 pages of transcript, almost 5,000 pages of briefs, and thousands of exhibits. Faced with this undigested mass of evidence, the Petitioners could not be expected to focus its briefing and argument on the critical evidence — namely, those pieces of evidence that formed the basis of the STJ's report. The STJ's report would critically undermine certain legal theories and bolster others, by investing some witnesses' statements with a presumption of truth and other witnesses' statements with a presumption of falsity. Without knowing which witnesses were regarded by the STJ as credible, the Petitioners were incapable of showing to either the Tax Court itself in a post-trial motion or to the Seventh or Eleventh Circuits that the Tax Court committed clear error in light of the presumptively correct view of the facts. In effect, the Petitioners were denied the possibility of arguing that the Tax Court had failed to credit the presumptions that governed the evidence, because the Petitioners did not know how the STJ's report credited the evidence.

The Due Process clause forbids a tribunal from forcing the Petitioners to litigate in the dark, ignorant of the presumptions that govern the proof. Just as Gonzales "was entitled to know the thrust of the Department [of Justice]'s recommendation so he could muster his facts and arguments to meet its conten-

tions," *Gonzales* at 414, the Petitioners were entitled to know the recommendations of the STJ's report so that it could tailor its arguments before the Tax Court and the appellate courts to that report's presumptively correct view of the facts. There is no question but that *Gonzales* applies to the reports of hearings officers as well as advisory investigative reports. *See, e.g., Crotty v. Kelly*, 443 F.2d 214, 216-17 (1st Cir. 1971) (draft registrant seeking status as conscientious objector is entitled to copy of hearing officer's report, because otherwise registrant "could not effectively present his position to the Board"). Indeed, *Gonzales* applies with even greater force to the fact-findings of trial judges when those findings are invested with the legal status of being the presumptively correct view of the facts. The Selective Service Appeals Board in *Gonzales* was under no legal obligation to defer to the FBI report. By contrast, the Tax Court is legally obliged to defer to the STJ's findings on credibility.

C. Because the STJ's report is legally entitled to a presumption of being correct under Rule 183(c), that report is not part of the Tax Court's purely internal deliberations.

The Commissioner argues that the STJ's report was simply part of the internal process by which judges deliberate among themselves and, therefore, is immune from disclosure. Apparently drawing an analogy between draft judicial opinions and the STJ report, the Commissioner notes that "communications between the judges (and special trial judges) to whom a case is assigned for disposition are not produced or disclosed to the parties." Commissioner's Brief in Opposition to Cert., at 9.

This assertion, however, ignores the legal authority of the STJ's report. That report was not a purely internal communication between judges but rather the

officially sanctioned, legally required, and presumptively correct statement of findings by the trial judge. As the official statement of the judge's findings, it bore no resemblance to confidential judicial deliberations. Such internal deliberations have no legally operative effect on the parties or the tribunal itself. Therefore, disclosure of such documents to the parties would serve no purpose except to embarrass the tribunal with a judge's preliminary and perhaps tentative thoughts on a case. Thus, it is not surprising that courts universally hold that such deliberations should not be disclosed to the parties and that the tribunal's official opinion, not evidence of the judge's behind-the-scenes thought-processes, should determine the meaning and scope of the tribunal's decisions. *See, e.g., Fayerweather v. Ritch*, 195 U.S. 276, 306-07 (1904) (preclusive effect of trial judge's opinion determined by normal rules of *res judicata* rather than judge's later testimony of what he subjectively considered).

By contrast, under Rule 183(c), the STJ's report has at least some legal force and cannot be disregarded by the Tax Court at will: the Tax Court is legally bound to pay "due regard" to the report's evaluations of witnesses' credibility and generally accept the report's findings as presumptively correct. This report, therefore, is wholly unlike preliminary judicial discussions that have no legal effect on judicial discretion (*e.g.*, a draft of a judicial opinion, a law clerk's bench memo, or a staff attorney's recommendation), because the STJ's report constrains the Tax Court's discretion, if only in the sense that the Tax Court cannot ignore that report altogether. Disclosure of this legally constraining document is essential if the parties are to know the presumptions that govern the proof that they have submitted.

For the purpose of distinguishing the STJ's report from judges' internal deliberations, the precise level of deference owed by the Tax Court to the STJ's findings

is immaterial. Whether or not the Tax Court must uphold the STJ's findings absent clear error, as the D.C. Circuit has held, *Stone v. Commissioner*, 865 F.2d 342, 346-47 (D.C. Cir. 1989), it is indisputable that Rule 183(c) requires that "the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Under the Tax Court's own rules, therefore, the STJ's report constrains the Tax Court's discretion to some degree. This rule follows the doctrine universally adopted by this and all lower courts that the findings of the officer who actually heard the testimony is, at the very least, highly relevant to the question of that testimony's credibility and thus to the question of whether an agency's decision is supported by substantial evidence. *Universal Camera*, 340 U.S. at 496; n.2 *supra*. Whatever the precise level of deference due to the STJ's report, it is beyond dispute that the Tax Court owes *some* deference to that report, if Rule 183(c) has any meaning whatsoever. Any such deference suffices to destroy any analogy between the report and purely internal judicial deliberations that can have no effect on the legal sufficiency of the evidence.

Rule 183(c)'s requirement of at least some minimal deference to STJ's report is not merely a technicality. Rather, it is the regulatory embodiment of an important due process requirement — namely, the requirement that the findings of the judge who actually hears the testimony will receive careful consideration by the ultimate decision-maker on the issue of the witnesses' credibility. Absent such careful consideration, the parties' oral presentation of evidence, their "day in court," becomes a meaningless exercise. Due process does not permit the ultimate decision-maker to dispense so cavalierly with consideration of the parties' own oral testimony, at least in the context of a traditional adjudication of a private individual's liberty or property interests. *Morgan v. United States*, 298 U.S. 468, 481 (1936)("If the one who determines the facts

which underlie the order has not considered evidence or argument, it is manifest that the hearing has not been given").[6]

The trial before the STJ was a traditional adjudication by an Article I judge of an individual's property rights. *Freytag v. Comm'r*, 501 U.S. 868, 881-82 (1991) (Special trial judges function as traditional judges in that they "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders"). As with the hearing before any other trial judge, the hearing before the STJ was the parties' only opportunity to present in-person their version of events in a court of law. When a trial judge presides over the only venue in which the parties' in-person testimony can be heard, then the findings of that judge cannot be regarded as purely internal advice that the agency can withhold from the parties. *Cf. Willner v. Comm. on Character & Fitness*, 376 U.S. 96, 104 (1963) (rejecting the view that the Committee on Character & Fitness "is an investigator not a trier of facts" on the ground "the Appellate Division has held no hearings of its own to determine an applicant's character," indicating that "the role of the Committee is more than that of a mere investigator").

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[6] Whatever the force of *Morgan*'s famous statement that "[t]he one who decides must hear" in administrative decision-making, *Morgan*, 298 U.S. at 481, it has greater force in the context of adjudications an individual's property or liberty interests. *See United States v. Raddatz*, 447 U.S. 667, 681 n.7 (1980) ("we assume it is unlikely that a district judge would *reject* a magistrate's proposed findings on credibility when those findings are dispositive and substitute the judge's own appraisal; to do so without seeing and hearing the witness or witnesses whose credibility is in question could well give rise to serious questions which we do not reach").

D. Because the STJ's report is legally entitled to a presumption of being correct under Rule 183(c), that report is distinguishable from the reports of the Division of the Tax Court.

The legal status of the STJ's report also distinguishes it from the reports of the divisions of the Tax Court. Unlike the reports of the STJs, no rule of the Tax Court requires that the reports of the divisions of the Tax Court shall be presumed to be correct. Not surprisingly, 26 U.S.C. §7460 provides that this non-binding document "shall not be a part of the record in any case in which the chief judge directs that such report shall be reviewed by the Tax Court." Having no legally constraining effect on either the Tax Court or the parties, the Due Process clause does not require the disclosure of the division's reports. *Estate of Varian v. Comm'r of Internal Revenue*, 96 F.2d 753, 755 n.2 (9th Cir. 1968) (holding that report of division of Tax Court need not be disclosed). The non-disclosure of such non-binding decisions of the Division, however, do not suggest that the reports of the STJ can similarly be withheld. Unlike the division's reports, the STJ's reports are invested with the legal presumption of being correct. It is plausible that the Tax Court distinguished between the reports of the division and the STJ in this manner because, unlike the division judge who could append his or her findings to a dissenting opinion, the STJ has no mechanism for publishing its differing view of the evidence if the Tax Court were to reject the STJ's findings.[7] But regardless of the justification for the difference in the Tax Court's treatment of the reports of the division

[7] As Judge Cudahy noted, "the STJs are not equal to the Tax Court judges and it might be naive to assume that the STJs have an equal voice in the collaborative process that results in Tax Court opinions." *Estate of Kanter*, 337 F.3d at 887 (Cudahy, J., dissenting).

and the STJ, the Tax Court does, in fact, treat the latter but not the former as presumptively correct. Having seen fit to confer such a legal status on the STJ's initial report, the Tax Court cannot then withhold such a critical document from the parties.

II. THE TAX COURT HAS NO LEGITIMATE REASON, SUCH AS AVOIDANCE OF ADMINISTRATIVE BURDEN, FOR REFUSING TO DISCLOSE THE STJ'S REPORT WHEN RULE 183(B) ALREADY REQUIRES THE STJ TO SUBMIT SUCH A REPORT TO THE TAX COURT.

Disclosure of the STJ's report would be virtually costless to the government. Indeed, the Commissioner has never described any burden that could result from such disclosure. The Petitioners do not ask the STJ to generate a new or different report, with the attendant delay and cost that such a task might entail. They ask only that the Tax Court simply disclose a report that already exists and is already required by the Tax Court's regulations. Rule 183(b) of the Tax Court's Rules of Practice and Procedure already require that "the Special Trial Judge shall submit a report, including findings of fact and opinion, to the Chief Judge [of the Tax Court]." Requiring that this already-existing report be disclosed imposes no significant "fiscal and administrative burdens" on the Tax Court. *Mathews v. Eldridge*, 424 U.S. at 348 (noting that "the Government's interest, and hence that of the public, in conserving scarce fiscal and administrative resources is a factor that must be weighed").

The Commissioner's brief in opposition to certiorari cites decisions holding that agencies are not always constitutionally required to create written fact-findings. *See* SG Brief in Opposition to cert., at 10 (citing *Utica Mut. Ins. v. Vincent*, 375 F.2d 129, 131 (2nd Cir. 1967)). But these cases are irrelevant to the

issue here. As this Court noted in *Gonzales v. United States*, 348 U.S. 407, 412 n.4 (1955), decisions addressing whether "a recommendation or intermediate report is necessary to begin with" are "inapplicable" to the distinct question of whether an agency must merely disclose a report that is already required by regulation or statute. It is, perhaps, arguable that, at least for certain sorts of "legislative" policy-making, an agency can reach a decision based on a paper record without even a written report of findings from the officer who actually heard the witnesses' testimony. *See Utica Mut. Ins. v. Vincent*, 375 F.2d 129 (2nd Cir. 1967).[8] But where a tribunal itself declares in its own rules that it will rely on a written report of a trial judge, then it defies common sense to say that the tribunal will somehow suffer some administrative burden if the report which the tribunal already possesses is disclosed to the parties.

Courts undoubtedly need some discretion to define for themselves how they will evaluate evidence. *Morgan v. United States*, 298 U.S. 468, 481 (1936) ("Assistants may prosecute inquiries. Evidence may be taken by an examiner. Evidence thus taken may be sifted and analyzed by competent subordinates. Argument may be oral or written. The requirements are not technical"). However, once the agency has exer-

[8] As Judge Friendly emphasized in *Utica Mutual Insurance*, a hearing on whether a bargaining unit should be certified does not require trial-type procedures, because the nature of the underlying issue is more legislative than adjudicative, *Utica Mut. Ins.*, 375 F.2d at 132-33, and because "Utica has no 'property right' in the designation of the unit of its employees with which it may be required to bargain, even though the National Labor Relations Act entitles it to be heard thereon." *Id.* at 134. Where a tribunal adjudicates an individual's private rights, the failure of the tribunal to consider the report of the officer who actually heard the testimony raises more troubling issues of due process. *See, e.g., Cullen v. United States*, 194 F.3d 401, 406 (2nd Cir. 1999) (district judge may not reject magistrate's credibility judgments without having heard live witnesses, as this practice raises "troubling questions of constitutional due process.").

cised this discretion by giving a trial judge the power to make presumptively correct findings of fact, then that agency is estopped from saying that further disclosure of those findings is somehow unnecessary or impractical.

Indeed, the only apparent burden of disclosing the STJ's report is the burden of being forced to justify any discrepancies that might exist between the report of the STJ and Tax Court's opinion. But this is simply the normal burden of appellate review to insure that a decision is supported by sufficient evidence. Like any other court, the Tax Court has no legitimate interest in making such appellate review more difficult by making the evidentiary basis for its decision less transparent.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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